Department of the Navy Fiscal Year 2013 Annual Financial Report

Protecting Freedom Under Extraordinary Circumstances

2013

Report Documentation Page

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Department of the Navy Fiscal Year 2013 Annual Financial Report

Protecting Freedom Under Extraordinary Circumstances

Heaving the phone and distance line aboard an amphibious transport dock ship while conducting a replenishment-at-sea. (U.S. Navy photo by Mass Communication Specialist 2nd Class Gary Granger Jr./Released)

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THE SECRETARY OF THE NAVY
WASHINGTON, DC 20350-1000

December 2013

The unique ability to provide a constant global presence is the essence of the Department of the Navy. For over 238 years, our brave Sailors and Marines have deployed in times of peace and war to protect our national interests, deter our potential enemies and reassure our allies and partners. As the most formidable expeditionary fighting force the world has ever known, our uniformed and civilian Sailors and Marines provide unsurpassed military capability and compassionate humanitarian aid wherever catastrophe strikes. Time and again, our people, our greatest military advantage, have risen to the occasion, providing the presence that enables us to be in the right place, not just at the right time, but all the time. It is truly an honor to work with such an outstanding team of men and women who sacrifice so much to protect our great nation and democratic ideals.

During 2013, the DON remained vigilant in addressing actions associated with the end of Iraqi operations and in preparing for the 2014 drawdown in Afghanistan, while carrying out current missions in dangerous environments. We successfully navigated the challenges of sequestration in 2013 and are positioning ourselves for reduced budgets, as we transition from a period of war spending to prepare to meet future threats.

Our focus has been on what we call the "Four P's"— *People*: taking care of those who sacrifice so much for our country, such as our wounded warriors; *Platforms*: continuing efforts to build ships, aircraft, submarines, unmanned vehicles, and hardware needed to combat future threats; *Power*: pursuing energy efficiencies and alternative energy sources to reduce our use of fossil fuels and build a green fleet; and *Partnerships* : improving relations throughout the world through collaboration.

We continue to strengthen our financial and business operations and to enhance the quality of underlying financial and performance information. The importance of sound financial management is magnified in times of reduced budgets. Our commitment to efficient, accountable, and transparent financial processes has the strong support of our senior military and civilian leaders.

The DON's Fiscal Year 2013 Annual Financial Report, *Protecting Freedom Under Extraordinary Circumstances*, highlights our mission, goals, and accomplishments. It demonstrates our commitment as fiscal stewards to spend funds entrusted to us wisely – for the right reasons, at the right time, to meet our highest priorities – with full accountability and transparency for results in accomplishing our mission to protect the United States and make the world a safer place.

The significant accomplishments of the DON during fiscal year 2013 are a testament to our people. We are proud to serve our country and commit to the American public continued unparalleled power at sea through a strong, flexible, and efficient fighting force.

Ray Mabus

THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

November 2013

Navy and Marine Corps financial managers continue to provide exceptional support to the world's finest expeditionary force as it carries out the Department of the Navy's mission around the globe in defense of our nation. We are proud to contribute to the effective and efficient deployment of resources across the DON, while ensuring public confidence that the Department is spending its dollars wisely to meet its highest mission priorities and can provide a full accounting for its costs and results.

This year introduced a new set of financial challenges as the DON operated for six months under a continuing resolution and absorbed $4.3 billion in sequestration reductions to its operations and maintenance funding.

These reductions were effectively managed through aggressive initiatives to reduce costs while protecting essential mission funding directly supporting warfighter readiness. The Department was forced to cancel surface ship and aircraft maintenance periods for the last six months of the fiscal year; delay maintenance of runways, roads, and buildings; reduce steaming and flying hours; and unfortunately, furlough civilian employees. Costs associated with travel, training, major acquisitions and base maintenance were reduced through improvements to business operations such as the increased use of electronic commerce and learning. While near term readiness and warfighting needs were met, the longer term impact of programmatic reductions has yet to be fully felt and assessed.

The Department remains mindful of fiscal challenges as we move into 2014 and remains committed to the ongoing transformation of our financial enterprise. Audit readiness remains a top priority as we work to strengthen and streamline financial management operations, systems and internal controls; expand the use of data analytic tools; promote standardization; and enhance our financial workforce through the Department of Defense financial management certification program.

The civilian and military leaders in the Department are committed to effectively and efficiently managing the resources entrusted to us with the highest degree of integrity and dedication on behalf of the American people we are so honored to serve.

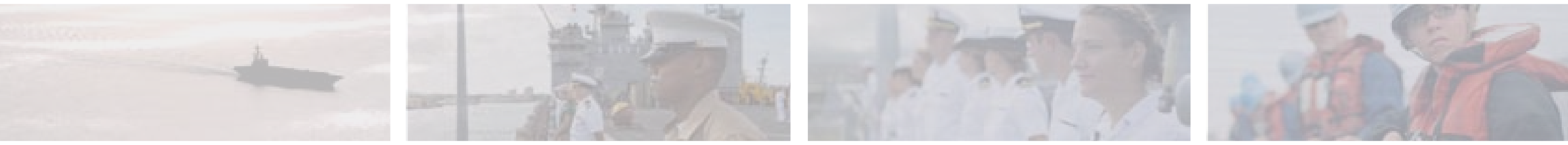
The DON's Fiscal Year 2013 Annual Financial Report, *Protecting Freedom Under Extraordinary Circumstances*, recognizes our significant efforts to continue improving financial management, performance, accountability and transparency.

S.J. Rabern

Protecting Freedom Under Extraordinary Circumstances

Department of the Navy Fiscal Year 2013 Annual Financial Report

Management's Discussion and Analysis



A Boatswain's Mate directs an aircraft before it takes off from the flight deck aboard an amphibious assault ship in support of maritime security operations and theater security cooperation efforts. (U.S. Navy photo by Mass Communication Specialist 3rd Class Brian Jeffries/Released)

OVERVIEW

The Department of Defense includes three military departments (Department of the Army, Department of the Navy, and Department of the Air Force); however, there are four separate service branches (Army, Navy, Marine Corps, and Air Force). Since 1834, the Navy and Marine Corps have been housed together under the Department of the Navy.

The United States Navy was founded on 13 October 1775, and the Department of the Navy (DON) was established on 30 April 1798. The Department of the Navy has three principal components: the Navy Department, consisting of executive offices mostly in Washington, D.C.; the operating forces, including the Marine Corps, the reserve components, and, in time of war, the U.S. Coast Guard (in peace, a component of the Department of Homeland Security); and the shore establishment. The Department of the Navy consists of two uniformed Services: the United States Navy and the United States Marine Corps.

The United States Marine Corps was founded by an act of the Second Continental Congress on 10 November 1775. As the nation's Expeditionary Force in Readiness, the Marine Corps provides power projected from the sea, utilizing the mobility of the U.S. Navy to rapidly deliver combined-arms task forces in coastal regions or emergent global crises. The Marine Corps has evolved into a balanced air-ground task force with significant logistical capabilities in forward deployed and forward engaged areas shaping, training, deterring, and responding to all manner of crises and contingencies.

During Fiscal Year 2013 we were reminded of the enduring service, sacrifice, and dedication of our Sailors, Marines, and civilians as they protect our freedom under extraordinary circumstances. Afloat and in the field, our Sailors and Marines contributed to overseas contingency operations in Afghanistan, a successful conclusion of the war in Iraq, and a wide range of operations including maritime security, stabilization, homeland security, counterterrorism, and disaster relief. At home, the Navy family was shaken by a senseless act of violence at the Washington Navy Yard that cost the lives of twelve Naval Sea Systems Command civilians who loved their country, loved their Navy, and loved the fleet that they helped build and sustain. Their contributions and memory will endure in the hearts of our nation and the Navy family. In the wake of the devastating events at the Navy Yard, the Navy has rallied together in support of all who were affected by this shocking tragedy. This event has also caused the Department to reassess security around all naval bases and installations. The Navy established the Emergency Family Support Task Force for people and organizations interested in providing support for families of the victims involved in the Washington Navy Yard shooting.

Checking bearings in the pilot house of a guided-missile frigate as the ship prepares to enter the Panama Canal. (U.S. Navy photo by Lt. Cmdr. Corey Barker/Released)

The DON continues to operate forward across the globe, providing the nation offshore options to deter and defeat aggression today and in the future. The Navy and Marine Corps team provides unique capabilities that will prove crucial as our Nation's strategic focus shifts to the Asia-Pacific region. The mobilization of warships will be accompanied by an increase in the number of military exercises conducted by the Pentagon in the region, involving air, sea, and land forces. Most will be carried out in conjunction with countries that are openly or tacitly allied with the U.S., including Japan, South Korea, Australia and the Philippines. Essential to the National Defense strategy are the DON's efforts to strengthen alliances and partnerships in the Asia-Pacific region to advance a common security vision for the future. The DON plans to develop military to military relations by creating teams to work on difficult issues such as cyber threats.

The DON has employed strategic partnerships to combat today's extraordinary challenges, showcasing our commitment to improving relations throughout the world and protecting our independence. The Navy and Marine Corps have conducted integrated operations in an effort to address the needs in the Mediterranean and Middle East. As the war in Afghanistan nears its end and demands for naval crisis response grow, working together is the only way to protect freedom. The DON will continue its investment in critical alliances such as the North Atlantic Treaty Organization (NATO).

The DON will face additional challenges in meeting its mission, as budget constraints have led to a leaner workforce. In order to prioritize resources, the DON has instituted the 21st Century Sailor and Marine initiative. This initiative defines a set of objectives and policies around a broad definition of wellness to maximize every Sailor and Marine's personal readiness to contribute to the DON's mission. In the second year of implementation, the program has maximized Sailor and Marine personal readiness and built resiliency to improve the most combat-effective force in the history of the Navy and Marine Corps. In an era of budget cuts, the DON has remained focused on maintaining U.S. maritime dominance by having Sailors and Marines continue to promote security, stability, and trust around the world. Together, the DON has provided a persistent forward presence, power projection abroad, and protection of the world's sea lanes.

Although this is an era of reduced budgets and The Budget Control Act of 2011 mandates a reduction of Federal spending, the DON will continue to operate as it does. As such, the DON is dedicated to cutting costs in the coming years by reducing the cost of doing business, promoting acquisition excellence, driving innovative transformation, and leading the nation in sustainable energy. While the DON maintains a healthy industrial base

A marine breaks during a patrol with the Afghan National Civil Order of Policemen in Afghanistan. (U.S. Marine Corps photo by Combat Camera)

to ensure future innovation and technological advances, the DON remains focused on identifying efficiencies to tighten budget execution while better aligning weapon system procurements with future mission requirements. As such, the DON has decreased the construction of new ships, terminated the procurement of the ocean surveillance ship and reduced and/or delayed the procurement of various other projects.

Readily available energy is essential for deploying our Sailors and Marines around the globe in support of our nation's interests. Since our operational flexibility and sustainability are directly linked to our energy supplies, energy reliability is a strategic concern for our forces. The potential vulnerability of energy supplies could threaten our ability to perform on the battlefield, and energy costs siphon resources from war fighting requirements. Therefore, the DON is working to develop greater energy independence and conservation ashore and afloat. Energy reform improves the capability and efficiency of ships, aircraft and weapon systems, and ultimately makes us better warfighters and ensures the safety of our Sailors and Marines. In the fall of 2009, Secretary Mabus set an ambitious energy goal for the Navy and Marine Corps that, by no later than 2020, at least half of all the energy used by the two services, both afloat and ashore, will come from non-fossil fuel sources. At the same time, at least half of all bases will be net-zero in terms of consumption, and in many cases returning power to the grid rather than pulling from it.

The Navy and Marine Corps continued to make significant progress toward reaching the Secretary's energy goals in 2013. The Navy is also working to improve the efficiency of bases by monitoring electricity usage in buildings, signing contracts for larger uses of solar power, and is considering geothermal, hydrothermal, wave, solar, and wind. This commitment to changing the way energy is used and produced will help the Navy in preserving the environment and planning for and mitigating the harmful effects of climate change. The Navy's priorities include developing clear goals and performance assessments that will help to transform the entire department. The Navy continues to focus on sustainable energy by offering military contract opportunities to small businesses with sustainable energy programs, pilots, and initiatives. The Navy's efforts to support a clean energy economy will make Americans better stewards of our planet.

The DON recognizes the value of investing in audit readiness as part of the Department of Defense (DoD) mission. The path to auditability will result in improved stewardship, reduced cost of business operations,

Pacific Partnership 2013 personnel man the rails on the amphibious dock landing ship USS Pearl Harbor. (U.S. Navy photo by Mass Communication Specialist 3rd Class Samantha J. Webb/Released)

and compliance with Congressional direction. In FY 2013, the U.S. Marine Corps continued the Statement of Budgetary Resources (SBR) audit. Concurrently, the DoD Financial Improvement and Audit Readiness (FIAR) team is preparing the rest of the Department for SBR audit readiness, with focused efforts to ready people, processes, and business systems for a financial audit. The DON understands fundamental improvements that establish tighter internal controls and more standardized processes are needed within its operations. To standardize and enforce uniform business processes, especially within disparate commands, the DON is in the process of fully implementing the Navy Enterprise Resource Planning (ERP) system across all Commands. The DON has employed control gap analysis to identify when a command's process and/or controls differ significantly from suggested controls, allowing the DON to track and address significant deviations.

The DON continues to demonstrate its commitment to effectively managing and mitigating risks while making progress toward desired mission outcomes by establishing objectives for FY 2014 and beyond. Given the current climate of budgetary restrictions and uncertainty, it is critical that the DON tracks progress and monitors change pertaining to the following high priority objectives:

- Take Care of Our People
- Maintain Warfighter Readiness in an Era of Reduced Budgets
- Lead the Nation in Sustainable Energy
- Promote Acquisition Excellence and Integrity
- Dominate in Unmanned Systems
- Drive Innovative Enterprise Transformation



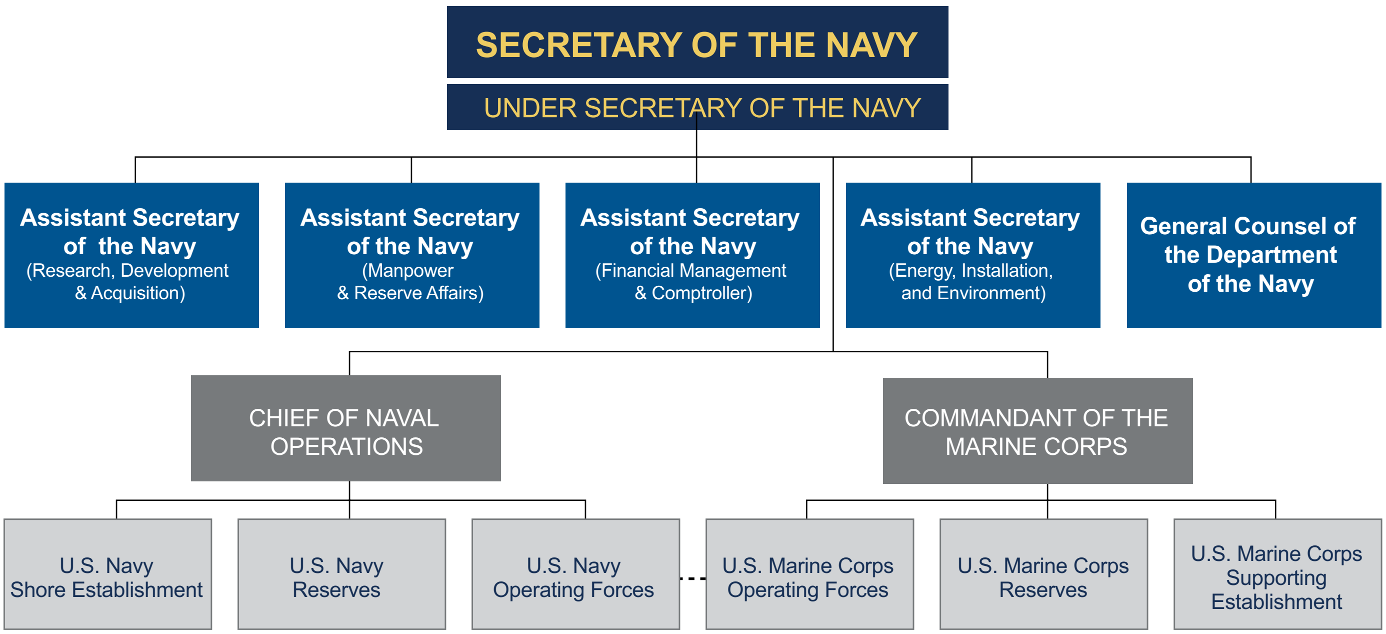

A naval aircrewman assists the pilot of an MH-60S Sea Hawk helicopter while conducting a vertical replenishment with an aircraft carrier. (U.S. Navy photo by Mass Communication Specialist 3rd Class Jamie V. Cosby/Released)

To maintain, train, and equip combat-ready Naval forces capable of winning wars, deterring aggression, and maintaining freedom of the seas.

-Department of the Navy Mission

FOUNDED 30 APRIL 1798

Title 10 U.S. Code, Section 5061



*Dashed line signifies collaboration of the U.S. Navy and the U.S. Marine Corps operating forces.

ORGANIZATION AND MISSION

The Department of the Navy, established on 30 April 1798, has three principal components: The Department headquarters, consisting of executive offices mostly in Washington, D.C.; the Naval and Marine Corps operating and reserve components, and the shore establishment. In time of war, the U.S. Coast Guard (a component of the Department of Homeland Security during peacetime) is under the operational control of the Department of the Navy. All are structured to respond to a broad range of mission priorities that preserve the nation's freedom and protect U.S. global interests.

The Secretary of the Navy (SECNAV), a civilian appointed by the President, is responsible for, and has authority under title 10 of the United States Code, to conduct all the affairs of the DON, including recruiting, organizing, supplying, equipping, training, mobilizing, and demobilizing. The SECNAV also oversees the construction, outfitting, and repair of naval ships, equipment, and facilities. The SECNAV is responsible for the formulation and implementation of policies and programs that are consistent with the national security policies and objectives established by the President and the Secretary of Defense. Under the purview of the SECNAV are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, the General Counsel, and two key military leaders—the Chief of Naval Operations, a four-star Admiral, responsible for the command and operating efficiency of the U.S. Navy, and the Commandant of the Marine Corps, a four-star General responsible for the performance of the U.S. Marine Corps.

The U.S. Navy and the U.S. Marine Corps have numerous commands that operate under the authority and responsibility of a commander or other designated official and typically support a network of subordinate commands. Each command has a clearly defined mission that contributes to the DON's overall mission in support of the Department of Defense's responsibilities. Both Services provide ready forces to support the U.S. joint military commands in conducting their worldwide missions.

U.S. NAVY

The United States Navy was founded on 13 October 1775. The mission of the Navy is to maintain, train and equip combat-ready Naval forces capable of winning wars, deterring aggression and maintaining freedom of the seas. It is overseen by the Chief of Naval Operations (CNO), and consists of the Operating Forces and Shore Establishment. The Chief of Naval Operations is the senior military officer in the Navy. The CNO is a member of the Joint Chiefs of Staff, and is the principal naval advisor to the President and to the Secretary of the Navy on the conduct of war. He is also the principal advisor and naval executive to the Secretary on the conduct of naval activities of the Department of the Navy. The CNO's office is responsible for the command, utilization of resources and operating efficiency of the operating forces of the Navy and of the Navy shore activities assigned by the Secretary. The Navy operating forces commanders and fleet commanders have a dual chain of command. Administratively, they report to the Chief of Naval Operations and provide, train, and equip naval forces. Operationally, they provide naval forces and report to the appropriate Unified Combatant Commanders. The Commander of the Fleet Forces Command controls fleet assets on both the Atlantic and Pacific coasts for interdeployment training cycle purposes. As units of the Navy enter the area of responsibility for a particular Navy area commander, they are operationally assigned to the appropriate numbered fleet. All Navy units also have an administrative chain of command with the various ships reporting to the appropriate Type Commander. The shore establishment provides support to the operating forces (known as "the fleet") in the form of: facilities for the repair of machinery and electronics; communications centers; training areas and simulators; ship and aircraft repair; intelligence and meteorological support; storage areas for repair parts, fuel, and munitions; medical and dental facilities; and air bases.

The Department of the Navy Assistant for Administration (AA)

The Department of the Navy Assistant for Administration provides administrative management and support to the Office of the Secretary of the Navy (SECNAV), its 6,000 member Secretariat, staff offices, field activities and supported organizations. The command is comprised of administrative divisions focused on customer service, directives and records management, contract management, executive dining, facilities and support services, financial management, human resources, information technology, and security. DON/AA has 120 personnel and is headquartered at the Pentagon in Arlington, VA.

U.S. Fleet Forces Command (COMUSFLTFORCOM)

The U.S. Fleet Forces Command supports both the Chief of Naval Operations (CNO) and Combatant Commanders worldwide by providing responsive, relevant, sustainable Naval forces ready-for-tasking. COMUSFLTFORCOM provides operational and planning support to Combatant Commanders and integrated warfighter capability requirements to the CNO. Additionally, U.S. Fleet Forces Command serves as the CNO's designated Executive Agent for Anti-Terrorism/Force Protection (ATFP), Individual Augmentees (IA), and Sea Basing. In collaboration with U.S. Pacific Fleet, U.S. Fleet Forces Command organizes, mans, trains, maintains, and equips Navy forces, develops and submits budgets, and executes readiness and personnel accounts to develop both required and sustainable levels of fleet readiness. The U.S. Fleet Forces Command has 368 personnel and is headquartered in Norfolk, VA.

Commander, U.S. Pacific Fleet

The Commander, U.S. Pacific Fleet is the world's largest fleet command, encompassing 100 million square miles, more than half the Earth's surface. The Pacific Fleet consists of approximately 180 ships, nearly 2,000 aircraft and 125,000 Sailors, Marines and civilians. Commands that fall directly under the Pacific Fleet include "type" commands for surface ships, submarines, aircraft, and Navy construction. Operational commands that report directly to the U.S. Pacific Fleet include Third Fleet in the Eastern Pacific and Seventh Fleet in the Western

Pacific and Indian Ocean. U.S. Pacific Fleet protects and defends the collective maritime interests of the United States and its allies and partners in the Asia-Pacific region. In support of U.S. Pacific Command and with allies and partners, U.S. Pacific Fleet enhances stability, promotes maritime security and freedom of the seas, deters aggression, and when necessary, fights to win. Pacific Fleet is headquartered in Pearl Harbor, Hawaii.

Naval Sea Systems Command (NAVSEA)

The Naval Sea Systems Command has a force of 60,000 civilian, military and contract support personnel. NAVSEA engineers, constructs, procures, and maintains the Navy's ships and submarines and their combat systems. To accomplish this, NAVSEA manages 150 acquisition programs and manages foreign military sales cases that include billions of dollars in annual military sales to partner nations. NAVSEA strives to be an efficient provider of defense resources for the nation, and it plays an important role in the Navy Enterprise. As a Provider Command, it has the responsibility of directing resource sponsors into the proper mix of manpower and resources to properly equip the fleet. NAVSEA has the further responsibility of establishing and enforcing technical authority in combat system design and operation. These technical standards use the organization's specialized expertise to ensure systems are engineered effectively, and that they operate safely and reliably. The NAVSEA organization has 33 activities in 16 states and is headquartered at the Washington Navy Yard in Washington, D.C.

Commander, Navy Reserve Force (CNRFC)

Commander, Navy Reserve Force Command, also known as the U.S. Navy Reserve Force, delivers strategic depth and operational capability to the Navy, Marine Corps, and Joint Forces by providing mission-capable units and individuals in support of the full range of operations, from peace to war. The Navy Reserve Force represents approximately ten percent, or 59,100 personnel, of the Navy Total Force. The Navy Reserve provides essential warfighting capabilities and expertise, strategically aligned with mission requirements, valued for readiness, innovation, and agility. The military component of the Navy Reserve represents only six percent of the Navy's total military personnel budget but is a significant force multiplier for the active Navy. CNRF is headquartered in Norfolk, VA.

Bureau of Medicine and Surgery (BUMED)

The Navy Bureau of Medicine and Surgery provides high quality health care to beneficiaries in wartime and in peacetime, under the leadership of the Navy Surgeon General. Highly trained Navy Medicine personnel deploy with Sailors and Marines worldwide - providing critical mission support aboard ship, in the air, under the sea and on the battlefield. The Navy Medicine team of physicians, nurses, corpsmen, dentists and mental health providers work in tandem with the Army and Air Force medical personnel and coalition forces to ensure the physical and mental wellbeing of troops and civilians. Navy Medicine's military and civilian health care professionals also provide care for uniformed services' family members and retirees at military treatment facilities around the globe. BUMED has 63,000 active duty personnel and reservists, government civilians and contractors of Navy Medicine engaged in all aspects of expeditionary medical operations in support of the warfighter. BUMED is headquartered in Falls Church, VA.

Bureau of Naval Personnel (BUPERS)

The Bureau of Naval Personnel provides administrative leadership, policy planning, and general oversight for all Navy personnel. BUPERS strives to support the needs of the DON by providing the fleet with the right person in the right place at the right time, using the most efficient human resource processes possible. BUPERS also provides support services to sailors and is dedicated to ensuring sailor readiness and quality of life through its myriad of professional and personal/family focused programs. To that end, BUPERS provides financial and support services for several other Navy commands, including Naval

Education and Training Command (NETC), Navy Recruiting Command (NRC), and the three Navy educational institutions. BUPERS has 150 civilian personnel at its Arlington, VA location and 1,537 civilian personnel at the Millington, TN location.

Commander Navy Installations Command (CNIC)

Commander, Navy Installations Command is responsible for Navy-wide shore installation management. CNIC enables and sustains naval forces from the shore by designing, developing and delivering integrated shore capabilities to our fleet, the fighter and the family. The programs and services launch every shore-based ship, submarine and aircraft and take care of every sailor and their families. CNIC has approximately 58,000 personnel in 11 regions, 70 Installations and 126 Naval Operations Support Centers. CNIC has overall shore installation management responsibility and authority as the Budget Submitting Office for installation support and the Navy point of contact for installation policy and program execution oversight. CNIC is headquartered in Washington, D.C.

Field Support Activity (FSA)

Field Support Activity establishes, maintains and provides a system of financial services as the Budget Submitting Office (BSO) and Principal Administering Office (PAO) for assigned unified commands, Navy Headquarters and activities. FSA initiates action in matters pertaining to the provision of funds, manpower and contract management; evaluates resource utilization; and, initiates or recommends appropriate corrective action. Additionally, FSA approves/allocates the Official Representation Funds (ORF) for Director, Navy Staff (DNS), and Chief of Naval Operations (CNO) activities, and plans and programs for current and future resource requirements for activities within the DNS sponsorship. FSA has 37 personnel and is headquartered at the Washington Navy Yard in Washington, D.C.

Military Sealift Command (MSC)

The Military Sealift Command operates approximately 110 non-combatant, civilian-crewed ships that replenish U.S. Navy ships, conduct specialized missions, and strategically preposition combat cargo at sea around the world and move military cargo and supplies used by deployed U.S. forces and coalition partners. MSC operates six subordinate commands worldwide. Five operational commands function in the Atlantic, Pacific, Europe/Africa, Central and Far East areas. MSC is headquartered in Washington, D.C. and Norfolk, VA, with approximately 9,500 Department of the Navy civilian employees supporting its mission worldwide.

Naval Air Systems Command (NAVAIR)

The Naval Air Systems Command has a force of 23,400 personnel focused on research, design, development, and systems engineering; acquisition; test and evaluation; training facilities and equipment; repair and modification; and in-service engineering and logistics support. NAVAIR provides full life-cycle support of naval aviation aircraft, and weapon systems operated by Sailors and Marines. NAVAIR has military and civilian personnel stationed at eight locations across the continental United States and one site overseas. NAVAIR is organized into eight "competencies" or communities of practice including: Program Management, Contracts, Research and Engineering, Test and Evaluation, Logistics and Industrial Operations, Corporate Operations, Comptroller, and Counsel. NAVAIR provides support (people, processes, tools, training, mission facilities, and core technologies) to Naval Aviation Program Executive Officers and their assigned program managers, who are responsible for meeting the cost, schedule, and performance requirements of their assigned programs. NAVAIR is the principal provider for the Naval Aviation Enterprise, while contributing to national security. NAVAIR is headquartered in Patuxent River, Maryland.

Naval Facilities Engineering Command (NAVFAC)

The Naval Facilities Engineering Command delivers and maintains quality, sustainable facilities, acquires and manages capabilities for the Navy's expeditionary combat forces, provides contingency engineering response, and enables energy security and environmental stewardship. NAVFAC is a global organization with an annual volume of business in excess of $11 billion. NAVFAC has 18,000 Civil Engineer Corps officers, civilians and contractors who serve as engineers, architects, contract specialists and professionals to manage the planning, design, construction, contingency engineering, real estate management, environmental, and public works support for U.S. Navy shore facilities around the world. As a major Navy systems command and an integral member of the Navy and Marine Corps team, NAVFAC delivers timely and effective facilities engineering solutions worldwide. NAVFAC has 13 component commands and is headquartered at the Washington Navy Yard in Washington, D.C.

Naval Special Warfare Command (NSW)

The Naval Special Warfare Command's mission is to man, train, equip, deploy and sustain NSW forces for operations and activities abroad in support of combatant commanders and U.S. national interests. NSW is comprised of approximately 9,500 total personnel, including 2,600 active-duty Special Warfare Operators (SEALs), 700 Special Warfare Boat Operators, 745 reserve personnel, 4,250 support personnel, and more than 1,175 civilians. The NSW Force is organized around eight SEAL teams, one SEAL Delivery Vehicle Team, three special boat teams and supporting commands which deploy forces worldwide to meet the requirements of theater commanders. NSW constitutes 11 percent of U.S. Special Operations Forces and less than two percent of Navy forces. NSW is headquartered in San Diego, CA.

Naval Supply Systems Command (NAVSUP)

The Naval Supply Systems Command delivers sustained global logistics and quality of life support to the Navy, Marine Corps, and Joint warfighter. NAVSUP manages supply chains that provide material for Navy aircraft, surface ships, submarines and their associated weapon systems and provides centralized inventory management for Navy's non-nuclear ordnance stockpile. NAVSUP provides a wide range of base operating and waterfront logistics support services, coordinating material deliveries, contracting for supplies and services, and providing material management and warehousing services. NAVSUP is responsible for many of the quality of life programs including Navy Exchanges, Navy Lodges, the Navy Personal Property Program, and the Navy Postal System. Additionally, NAVSUP administers the Navy Food Service Program. NAVSUP is comprised of approximately 345 military personnel and more than 24,000 employees. NAVSUP is headquartered in Mechanicsburg, PA.

Office of Naval Intelligence (ONI)

The Office of Naval Intelligence is the leading provider of maritime intelligence to the U.S. Navy and joint warfighting forces, as well as national decision makers and other consumers in the Intelligence Community. ONI specializes in the analysis, production and dissemination of vital, timely and accurate scientific, technical, geopolitical and military intelligence information. The command supports a broad range of customers worldwide including the fleet, warfighters, the Navy acquisition community, national intelligence community, law enforcement agencies, foreign and coalition partners, and national decision makers. ONI employs more than 3,000 military, civilian, and mobilized reservists and contractor personnel worldwide, including analysts, scientists, engineers, specialists, and technicians. ONI is headquartered in Suitland, MD.

Office of Naval Research (ONR)

The Department of the Navy's Office of Naval Research provides the science and technology necessary to maintain the Navy and Marine Corps technological advantage. ONR's mission is to plan, foster, and encourage scientific research that assures our nation's continued

maintenance of dominant naval power and the preservation of national security. ONR manages Navy and Marine Corps basic and early applied research, as well as advanced technology development to foster science and technology transition to higher levels of research, development, test, and evaluation for ultimate use in the fleet and force. ONR provides technical advice to the CNO and the SECNAV. Led by the Chief of Naval Research, its senior leadership oversees a portfolio of investments ranging from immediate, quick-turnaround technologies to long term basic research. ONR employs approximately 1,050 people, comprising uniformed, civilian and contract personnel, with additional employees at the Naval Research Lab in Washington, D.C. ONR is headquartered in Arlington, VA.

Space and Naval Warfare Systems Command (SPAWAR)

The Space and Naval Warfare Systems Command is an acquisition command that delivers high-end Navy information technology products and services to the fleet and other Department of Defense stakeholders. As the Navy's information dominance systems command, SPAWAR designs, develops and deploys advanced communications and information capabilities. With more than 9,500 active duty military and civil service professionals located around the world and close to the fleet, SPAWAR is at the forefront of research, engineering, acquisition and support services that provide vital decision superiority to our forces at the right time and for the right cost. SPAWAR products and services transform ships, aircraft and vehicles from individual platforms into integrated battle forces, enhancing information dominance and awareness among Navy, Marine Corps, joint forces, federal agencies and international allies. SPAWAR is headquartered in San Diego, CA.

Strategic Systems Programs (SSP)

Strategic Systems Programs directs the end-to-end effort of the Navy's Strategic Weapon Systems to include training, systems, equipment, facilities and personnel, and fulfillment of the terms of the United States/United Kingdom Polaris Sales Agreement. SSP's six lines of business include the Strategic Weapons System, Nuclear Weapons System, Guided Missile Submarine (SSGN) Attack Weapons System, Payload Integrator, Emerging Missions, and Navy Treaty Implementation Program. SSP is headquartered at the Washington Navy Yard in Washington, D.C.

U.S. MARINE CORPS

The Marine Corps established on 10 November 1775 currently consists of 195,657 Active Duty Marines; 39,640 Select Reserve Marines; and 35,000 Inactive Ready Reserve (IRR). At any given time, approximately 30,000 Marines are forward deployed in operations supporting our nation's defense or Military Operations Other Than War (MOOTW).

HQMC consists of the Commandant of the Marine Corps and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law and higher authority. This includes the administration, discipline, internal organization, training, requirements, efficiency, and readiness of the service. The Marine Corps Headquarters is spread throughout the Washington, D.C. metro area, including the Pentagon, Marine Barracks, Quantico, and the Washington Navy Yard.

The Operating Forces are subdivided into four categories: Marine Corps Forces, including all Marine ground, aviation, and combat logistics; Marine Corps Reserves, Marines who support the Active Component by fielding deployable units; Security Forces, which protect key installations, vessels, units, and assets of the United States Government; and Special Activity Forces, who guard US embassies and foreign service posts.

The Supporting Establishment includes all bases, air stations, and installations. They assist in training, sustainment, equipping, and embarkation of deploying Marine Forces.

Headquarters, U. S. Marine Corps (HQMC)

Headquarters, U.S. Marine Corps (HQMC) consists of the Commandant of the Marine Corps (CMC) and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law. The Commandant is directly responsible to the Secretary of the Navy for the overall performance of the Marine Corps. This includes the administration, discipline, internal organization, training, requirements, efficiency, and readiness of the service. Also, as the Commandant is a member of the Joint Chiefs of Staff, HQMC supports him in his interaction with the Joint Staff. The Commandant also is responsible for the operation of the Marine Corps material support system.

Marine Corps Forces Command (MARFORCOM)

Located in Norfolk, Virginia, the Commander, MARFORCOM is tasked with: commanding Active Component (AC), Marine Corps-retained operating forces; executing force sourcing and synchronization to provide joint commanders with the Marine Corps forces they require; Directing deployment planning and the execution of Marine Corps-retained operating forces in support of combatant commander and service requirements; serving as Commanding General, Fleet Marine Forces Atlantic (CG FMFLANT) and commanding embarked Marine Corps forces; coordinating Marine Corps-Navy integration of operational initiatives and advising the Commander, U.S. Fleet Forces Command (USFF) on Navy support to Marine Corps forces assigned to naval ships, bases, and installations; serving as Commander, Marine Forces Europe; serving as Commander, Marine Corps Bases Atlantic; and conducting service-directed operational tasks as required.

U.S. Marine Corps Forces, Pacific (MARFORPAC)

MARFORPAC has three command roles and responsibilities. The command serves as U.S. Marine Corps component to U.S. Pacific Command (USPACOM), U.S. Marine Corps component to U.S. Forces Korea (USFK), and Fleet Marine Forces Commander to Pacific Fleet. In addition to its service component responsibilities, MARFORPAC could be tasked to act as a joint task force command element. With its headquarters located aboard Camp H. M. Smith, HI, MARFORPAC is the largest field command in the Marine Corps, having control of two-thirds of Marine Corps operational forces. Commander, MARFORPAC commands all U.S. Marine Corps forces assigned to USPACOM operating in a diverse geographic area stretching from Yuma, Arizona to Goa, India.

U.S. Marine Corps Forces, Special Operations Command (MARSOC)

MARSOC was formally established February 24, 2006 and is the Marine Corps component of USSOCOM. Headquartered at Camp Lejeune, NC, MARSOC trains, organizes, equips, and, when directed by the Commander USSOCOM, deploys task organized, scalable and responsive Marine Corps special operations forces (SOF) worldwide in support of combatant commanders and other agencies. MARSOC includes three subordinate commands: the Marine Special Operations Regiment (MSOR); the Marine Special Operations Support Group (MSOSG); and the Marine Special Operations School (MSOS) at Camp Lejeune, NC.

Marine Forces Reserve (MARFORRES)

Headquartered in New Orleans, Louisiana, MARFORRES is responsible for providing trained units and qualified individuals for active-duty service in times of war, national emergency, or in support of contingency operations. Marine Corps force expansion is made possible by activation of the Marine Corps Reserve. As an operational reserve, MARFORRES provides personnel and operational tempo relief for active component forces during times of peace. Like the active component, MARFORRES is a combined-arms force with balanced ground, aviation, and logistics combat support units. MARFORRES capabilities are managed through MARFORCOM as part of its global force management responsibilities for the Commandant. Commander, MARFORRES is also Commander, Marine Forces Northern Command (MARFORNORTH) and serves as the Marine component of NORTHCOM.

U.S. Marine Corps Forces, Cyberspace Command (MARFORCYBER)

Recognizing the significance of the cyberspace domain to national security, the Secretary of Defense directed the establishment of U.S. Cyber Command (CYBERCOM) as a sub-unified command under the U.S. Strategic Command. The primary objective of CYBERCOM is to integrate the computer network operations capabilities of the services and agencies in support of the National Strategy to Secure Cyberspace (NSSC). In response, the Marine Corps established U.S. Marine Corps Forces Cyberspace Command (MARFORCYBER) in October 2009. (This was complemented by the standing up of the Navy's U.S. Tenth Fleet/Fleet Cyber Command in January 2010.) MARFORCYBER's mission is to plan, coordinate, integrate, synchronize, and direct full spectrum Marine Corps cyberspace operations.

Marine Corps Installations Command (MCICOM)

Marine Corps Installations Command (MCICOM) has 24 active installations and 11 airfields, which are divided into three regions: Marine Corps Installations Pacific (MCIPAC), Marine Corps Installations East (MCIEAST), and Marine Corps Installations West (MCIWEST). The forces assigned to MCICOM provide timely support to the Marines, Sailors and families from the operating forces and maintenance depots. MCICOM directly supports Marine Corps Operating Forces, individual Marines, and family members. They are essential components in the foundation of national defense as they are the force projection platforms that support training, sustainment, mobilization, deployment, embarkation, redeployment, reconstitution, and force protection.

Marine Corps Logistics Command (MCLC)

Headquartered in Albany, Georgia, MCLC provides worldwide, integrated logistics, supply chain, and distribution management; maintenance management; and strategic prepositioning capability in support of the operating forces and other supported units. The services and support provided by MCLC maximize supported unit readiness, synchronize distribution processes, and support Marine Corps enterprise and program-level total life cycle management. MCLC is the Marine Corps Executive Agent for the tactical coordination, planning, and execution of ground equipment reset. MCLC is responsible for end-to-end ground equipment reset from Southwest Asia actions from theater, through the appropriate Operation Enduring Freedom (OEF) Reset Account and until all reset maintenance actions are complete.

Members of a color guard stand by as their ship arrives for a port visit. (U.S. Navy photo by Mass Communication Specialist 3rd Class Mel Orr/Released)

U.S. NAVY CIVILIANS: 184,445
(Full-time Equivalents)

U.S. NAVY ACTIVE: 323,951
(Officers, Enlisted, and Midshipmen)

U.S. NAVY RESERVE: 62,444
(Drilling Reserve and Full-time Support)

U.S. MARINE CORPS CIVILIANS: 23,272
(Full-time Equivalents)

U.S. MARINE CORPS ACTIVE: 195,657
(Officers and Enlisted)

U.S. MARINE CORPS RESERVE: 39,640
(Drilling Reserve and Full-time Support)

Personnel Data as of Fiscal Year Ended September 30, 2013

A marine fires the AT-4 antitank rocket towards an enemy during a raid exercise. (Photo by Lance Cpl. Corey Dabney).

STRATEGIC MANAGEMENT

The DON is committed to improving core capabilities that support the U.S. maritime strategy, "A Cooperative Strategy for 21st Century Seapower." These core capabilities are critical to U.S. maritime power and reflect an increased emphasis on activities that prevent war and build partnerships—forward presence, deterrence, sea control, power projection, maritime security, humanitarian assistance, and disaster response.

The cooperative strategy, guided by the objectives articulated in the National Strategy for Maritime Security, National Security Strategy, National Defense Strategy, and National Military Strategy, was developed to be a unified and enduring approach that will apply maritime power to the crucial responsibility of protecting vital U.S. interests in an increasingly interconnected and uncertain world. It binds the three maritime services—U.S. Navy, U.S. Marine Corps, and U.S. Coast Guard (during wartime)—closer together than ever before in a mission to more fully safeguard maritime interests at home and abroad.

Our six priority objectives support the U.S. maritime strategy by focusing on key efforts that will increase our effectiveness and improve the lives of our Sailors, Marines, and their families, which results in greater security for our nation and U.S. global interests. A summary of key accomplishments by objective begins below.

Objective 1: Take Care of Our People

Our Sailors, Marines, and civilians are all critical components of the U.S. maritime strategy, and we must ensure that we provide them with adequate compensation, medical care, and career training opportunities. These are key factors in attracting and retaining highly motivated and qualified military and civilian personnel. We remain committed to providing a competitive pay and benefits package to aid in recruitment and retention. The package includes basic pay, housing allowances, and incentives for critical specialties in health care, explosive ordnance disposal, and nuclear propulsion.

Capt. Sara Joyner during the national anthem. She became the 57th commander of Carrier Air Wing 3 at Oceana Naval Air Station, and is the first woman to lead a carrier air wing. (Photo by Vicki Cronis-Nohe, The Virginian-Pilot)

DON personnel heroically strive to protect freedom for the nation as they face extraordinary circumstances each and every day. The Department is therefore fully committed to promote the physical and mental wellness of Sailors and Marines who have dedicated their lives to serve their families, communities, and our great Nation.

In one initiative, the Navy and Marine Corps Public Health Center (NMCPHC) developed a web-based immersive experience tool that will assist service members in achieving a better psychological and physical state. This online application provides different relaxation techniques for users to practice including breathing exercises, muscle relaxation activities, meditation, and other practices that are designed to help improve mood and performance while simultaneously managing stress. The NMCPHC is part of the Navy Medicine team, a global health care network of 63,000 Navy medical personnel around the world who provide high-quality health care to over one million eligible beneficiaries.

The Navy is proud to uphold the standards of equality, freedom, and opportunity, and has made great progress as an organization. For the first time in the Navy's history, the role of women in the armed forces has been expanded such that every facet of military employment is available to them. On January 24, 2013, the Secretary of Defense and Joint Chiefs of Staff overturned the 1994 Ground Combat Definition and Assignment Rule. This directive allowed for the integration of women into previously-closed occupational specialties and has increased assignment opportunity for women in the Navy. Today, over 67,000 women serve in the Navy in the active and Reserve components, comprising 18 percent of the total force.

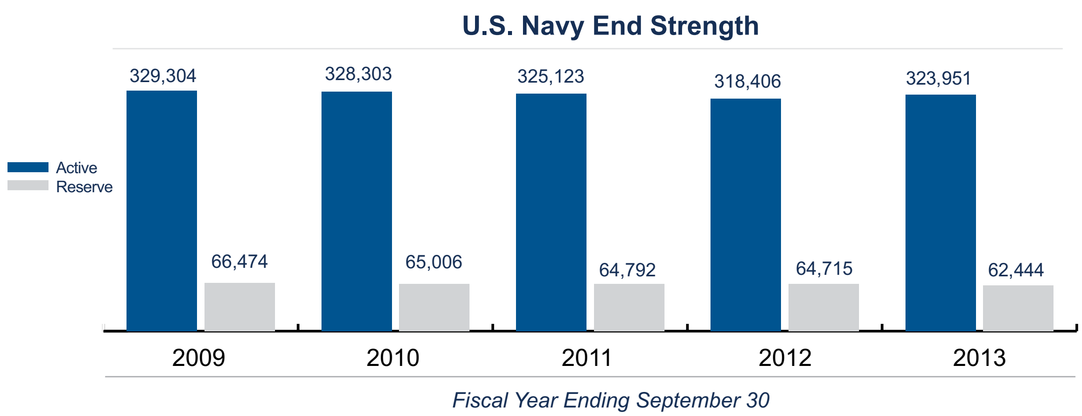
Brave servicemen and women from all walks of life are the cornerstone of the armed forces. The Navy has fostered an environment rich in equality and opportunity where individuals are safe from prejudice. The Gay, Lesbian, and Supporting Sailors (GLASS) organization is a group for lesbian, gay and bisexual Sailors and supportive members that was created in order to increase awareness among Sailors regarding the gay community. This year Sailors from guided-missile destroyer USS Shoup (DDG 86) established a branch of the GLASS organization aboard their U.S. Navy vessel.

The growth of the GLASS organization across the Navy is yet another example of the substantial progress the Navy has made in creating a military environment that is free from prejudice, bigotry, harassment, and violence.

Sailors participating in the Riverine Combat Skills course prepare for a field training exercise at Camp Lejeune, N.C. This class was the first training group composed of Coastal Riverine Force Sailors and the first to incorporate women into the course. (U.S. Navy photo by Mass Communication Specialist Seaman Heather M. Paape/Released)

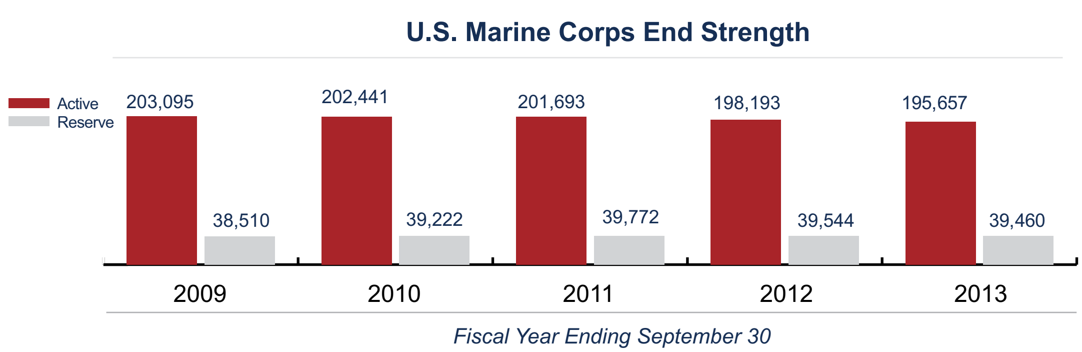
U.S. Navy

The Navy continues to resize and reshape its forces to meet its mission requirements more efficiently and effectively. This is especially important in an environment of limited budgetary resources and rising personnel costs. Over the last five years, the Navy has resized its active and reserve components by 2 percent and 6 percent, respectively. The Navy has been able to accomplish all assigned missions at this level because of force structure changes, efficiencies gained through technology, modifications in workforce mix, and new manning practices.



U.S. Marine Corps

The Marines Corps continues to provide a balanced force adequately postured for future National Security Strategy requirements, while supporting operations in a post-Afghanistan security environment requiring greater affordability. The Marine Corps enduring end strength of 182,100 and the corresponding ready and capable force structure will provide a strategically mobile, middleweight force optimized for rapid crisis response and forward-presence. The drawdown of the Marine Corps Active Component (AC) end strength from 195,657 to 182,100 will be completed by the end of FY 2016 at a ramp down of approximately 4,000 active personnel per year.

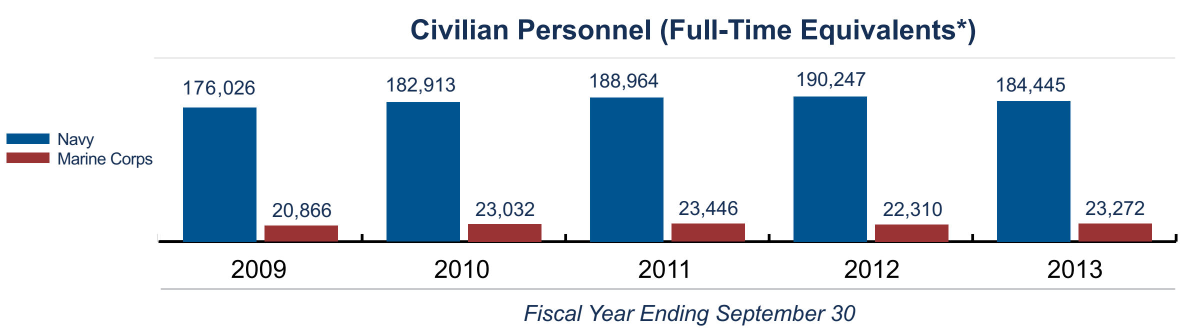


Marines depart from the stern gate of an amphibious assault ship in a combat rubber raiding craft. (U.S. Navy photo by Mass Communication Specialist 1st Class Brian P. Biller/Released)

Sailors conduct routine maintenance on a close-in weapon system (CIWS) aboard an aircraft carrier. (U.S. Navy photo by Mass Communication Specialist 2nd Class Timothy M. Black/Released)

Navy and Marine Corps Civilian Personnel

The size of the civilian workforce, which has increased by 4.4 percent over the last five fiscal years, continues to support the mission and daily functions of the Navy and Marine Corps. Civilian personnel provide various types of support, such as research and development, engineering, acquisition, depot maintenance, and financial management and budget.



* Full-time equivalents are the total number of regular straight-time hours (i.e., not including overtime or holiday hours) worked by employees divided by the number of compensable hours applicable to each fiscal year.

Objective 2: *Maintain Warfighter Readiness in an Era of Reduced Budgets*

Today's security environment has created new demands for naval forces. These demands include support for security, stabilization, transition and reconstruction operations, support for homeland security, and continued preparedness for contingency operations. The evolving dynamics of the 21st century security environment require our forces to be ready to deploy globally. Although we are in an era of reduced budgets, the DON will maintain strong, agile and capable military forces. Operational readiness is the catalyst that brings naval power to bear whenever it is needed. Our budget supports requirements for our Carrier Strike Groups (CSGs), Expeditionary Strike Groups (ESGs), and Marine Expeditionary Forces (MEFs) to execute the National Military Strategy and respond to persistent as well as emerging threats. Our Navy-Marine Corps

team has become an integral part of continuing overseas contingency operations. We continue funding the necessary requirements to ensure our ability to protect vital U.S. interests and assist our allies in crisis situations.

The DON's top readiness priority is ensuring that forces are fully supported while deployed. In order to do so, the DON requires a highly educated and trained, highly skilled and disciplined force. Using advanced technologies, we have shifted training from the traditional classroom to the use of simulators, trainers, computer-based interactive curricula, and other media-based approaches. This initiative provides our naval workforce with appropriate training in a more efficient manner and prepares them to better perform mission-critical tasks.

The fleet must be ready to protect freedom while meeting today's extraordinary challenges, today. Consequently, decisions must be centered on what Sailors and Marines need to perform their jobs effectively and efficiently. The Department has acquired and continues to invest in proven technology that Sailors can use and depend on at sea and ashore. Leadership has used empirical data, such as Board of Inspection and Survey report statistics, to shape decision making that ensures fleet readiness despite reduced funding.

Cost Savings through Innovative Technology

The Office of Naval Research (ONR) sponsored a web-based military transportation tool which will enable the Navy to move people and equipment more efficiently and affordably. The Transportation Exploitation Tool (TET) allows planners to identify available space aboard thousands of military and commercial flights, as well as ship movements that occur throughout the day in order to know the best route to send mission-critical supplies. Before TET, planners needed to search multiple databases to access all the military and civilian space, which took hours and in some cases days.

This system has already saved naval services over $30 million in transportation costs, with an estimated savings of $200 million over 10 years when it is fully implemented. The naval services continue to work on new technologies that save money while improving methods to provide our Sailors and Marines with the tools they need to be ready.

Maritime Security Operations

The Navy continues to safeguard and protect the Nation's interests by conducting operations to provide maritime security across the globe.

Sailors conduct firefighting training on an airfield using a Mobile Aircraft Firefighting Training Device, which can simulate 13 different aircraft fire situations. (U.S. Navy photo by Mass Communication Specialist 2nd Class Marcus L. Stanley/Released)

This year the Frigate USS Rentz and the U.S. Coast Guard Law Enforcement Detachment seized 2,123 lbs. of cocaine from a fishing vessel north of the Galapagos Islands worth an estimated value of $78 million.

Personnel from the Navy and the U.S. Coast Guard Law Enforcement detachment embarked aboard a guided-missile frigate, prepare an estimated $78 million of confiscated cocaine for transfer to a U.S Coast Guard cutter from a drug bust. (U.S. Navy photo by Lt. Cmdr. Corey Barker/Released)

The frigate USS Rentz was engaged in counter trans-national organized crime operations as part of an effort to target illicit trafficking routes in coastal waters along the Central American isthmus.

This warship worked closely with a U.S. Navy P-3 Orion long-range patrol aircraft operating in the region to initially detect and intercept the fishing vessel suspected of smuggling narcotics in international waters. This collaboration enabled the seamen abroad the frigate to discover and confiscate the large reserve of cocaine.

Objective 3: *Lead the Nation in Sustainable Energy*

The Navy is committed to improving energy security and environmental stewardship by reducing reliance on fossil fuels. The Navy is actively developing and participating in energy, environmental and climate change initiatives that will increase use of alternative energy and help conserve the world's resources for future generations.

Goddard Power Plant, the last coal-fired power facility operated by the Navy, will be demolished and replaced by a natural-gas cogeneration facility and infrastructure that will provide steam critical to energetic mission activities as well as 3.5 megawatts of electricity. (U.S. Navy photo by Gary Wagner/Released)

Reducing our naval forces' reliance on fossil fuels is critical to our national security, environment, and naval capabilities. Our nation and naval forces rely heavily on a finite source of fuel from volatile global regions. To a certain extent, we have ceded this strategic resource to other nations, creating an obvious vulnerability to our national security. In addition, our reliance on fossil fuels affects our naval forces' operational independence, both in terms of the resources required to obtain fuel and to transport it to the ships, aircraft, and equipment, and the Sailors and Marines whose duty it is to protect the ships and convoys moving the fuel.

With these risks in mind, we have taken a bolder, more aggressive stance toward energy reform by committing to five energy goals (see chart on next page). These goals require adoption of new fuels and development of new systems and energy efficient practices and techniques over the next 10 years. The DON's strategy in achieving these goals is centered on energy security, energy efficiency, and sustainability while remaining the preeminent global maritime power.

Efforts to Reduce Marine Corps Energy Consumption in Theater

Naval Surface Warfare Center (NSWC) Panama City Division engineers are working to reduce the energy consumption of Marine Corps combat operations centers in theater.

The NSWC engineers studied the operations centers and noted that almost 70 percent of total energy consumed was used to heat and cool shelters. They worked with engineers from the National Renewable Energy Laboratory (NREL) in Golden, Colorado to develop a model that accurately predicted shelter heat transfer and resulting effects on energy consumption. The computerized model predicts energy consumption requirements given various factors such as: shelter material, colors, radiant barriers, air vents, shades, and air infiltration rates. The model also has the ability to incorporate localized weather data and will allow field units to more accurately predict energy supply requirements for shelter heating and cooling during and prior to deployment.

These and other energy efficiency technologies can improve field tactics while also providing maritime warriors with greater tactical flexibility.

The Navy's Last Coal-Fired Power Plant

The Navy has a $62 million construction project to demolish the last remaining coal-fired power plant operated by the Navy. A new facility will be constructed for Naval Support Facility (NSF) Indian Head, MD that will provide the installation with decentralized steam and a 3.5 megawatt co-generation facility for electricity and steam.

The project will modernize utility services for the installation and improve combat and war fighting

Demonstrating Ground Renewable Expeditionary Energy (GREENs) apparatus at Naval Surface Warfare Center, Carderock Division. (U.S. Navy photo/Released)

DEPARTMENT OF THE NAVY ENERGY GOALS

ENERGY EFFICIENT ACQUISITION: Evaluation of energy factors will be mandatory when awarding contracts for systems and buildings.

SAIL THE "GREAT GREEN FLEET": The Green Strike Group demonstrated in local operations in 2012 will sail by 2016.

REDUCE NON-TACTICAL PETROLEUM USE: By 2015, the DON will reduce petroleum use in the commercial fleet by 50%.

INCREASE ALTERNATIVE ENERGY ASHORE: By 2020, the DON will produce at least 50% of shore-based energy requirements from alternative sources; 50% of the DON installations will be net-zero.

INCREASE ALTERNATIVE ENERGY USE DON-WIDE: By 2020, 50% of total DON energy consumption will be from alternative sources.

capabilities by reducing the vulnerabilities that were associated with having a coal fired facility. A combination natural gas turbine and heat recovery steam generator will replace the installation's Goddard Power Plant that was constructed in 1957. The new system will cut energy use by 50 percent, water consumption by 75 percent and steam requirements by 80 percent, resulting in approximately $7.5 million savings each year. In addition, an estimated 50 billion pounds of carbon emissions will be reduced each year.

Natural gas, a cleaner and more efficient fuel source, will serve as the primary fuel for the new steam- and power-generation facilities. The project also includes the construction of a new natural gas transmission line from Bryans Road to NSF Indian Head. The Navy is excited to replace the last standing coal-fired facility with a more efficient and environmentally friendly structure.

Objective 4: Promote Acquisition Excellence and Integrity

To protect U.S. national interests and achieve the objectives of the 2010 *National Security Strategy* in this environment, the Navy will need to recalibrate its capabilities and make selective additional investments to succeed in its missions. Despite the fact that The Budget Control Act of 2011 mandates the reduction of federal spending, the Navy fleet will be no smaller in the future than it is today. Therefore, as replacement costs of our aging ships, aircrafts, and weapon systems continue to rise faster than our procurement budget's top-line; the Navy must reduce the cost of doing business. This entails improving program execution, rebuilding the acquisition workforce, leveraging strategic sourcing and promoting competition, all while protecting a healthy industrial base.

During FY 2013, the DON continued to follow the DoD's Better Buying Power 2.0 (BBP 2.0) initiative. The initiative strives to implement best practices throughout DoD acquisition services to strengthen the buying power, improve industry productivity, and provide an affordable, value-added military capability to the Warfighter. The overall goal of the program is to create a set of fundamental acquisition principles to achieve greater efficiencies through affordability, cost control, elimination of unproductive processes and bureaucracy, and promotion of competition.

The Navy has followed the BBP 2.0 guidelines in its goal of promoting acquisition excellence. Purchases of large, multi-year, procurements have been planned out in advance using a competitive allocation strategy. For example, three ships at Bath Iron Works (BIW) and Huntington Ingalls Incorporated (HII) saved 12 percent in basic construction costs and an overall savings of $298 million to the government.

Objective 5: Dominate in Unmanned Systems

Unmanned systems expand our naval capabilities in intelligence, surveillance, and reconnaissance (ISR), and reduce the exposure of our naval forces to unnecessary threats. The DON's vision is to achieve an integrated, hybrid force of manned and unmanned systems with the ability to sense, comprehend, predict, communicate, plan, make decisions, and take appropriate actions to achieve its

goals. The employment of these systems will reduce risk for Sailors and Marines and increase capability.

The DON Office of Naval Research (ONR) developed a Common Control System (CCS), which enables different Defense military branches to work together on unmanned systems and services. This new update allows military branches to simplify unmanned systems, rely less on custom-built components/systems, and in turn, reduce costs to the different branches in DoD.

Historically, unmanned systems were developed and fielded as individual items built by different vendors. This has led to increased spending, from $284 million to over $3 billion in the last eight years. Each system is uniquely controlled by proprietary software created by various vendors, and the data provided is sent out in unique formats, making it impossible to control various systems with one master control or to uniformly examine the data being transmitted. The common controller solves this problem, will help to reduce costs, and allows the systems to work together.

Additionally, all of the data captured by the systems is saved in a cloud environment that is transparent across the military and easily accessible to and quickly navigable by all service members.

ONR worked with the OSD's Office of Strategic and Tactical Systems, Naval Air Systems Command, Naval Undersea Warfare Center, Program Executive Office (PEO) Integrated Warfare Systems and PEO Unmanned Aviation and Strike Weapons on this software. ONR validated that Unmanned Control Systems (UCS) can be used to develop common control services that provide total functionality for a particular Common Control System, the Bi-Directional Remote Video Terminal (BDRVT). ONR was able to provide OSD with a blueprint for all military services to be able to build a BDRVT using UCS developed common control services.

Objective 6: Drive Innovative Enterprise Transformation

During FY 2013 the Navy partnered on a variety of research projects. A partnership between the Office of Naval Research (ONR) and an oceanographer has launched a 24-hour website called "Exploration Now." The site operates similarly to a newsroom, tracking scientists' activity aboard research ships and in the field and broadcasting their findings to students and teachers around the world in real time.

The Exploration Now initiative provides students, educators and others with live-stream video of research activities and opportunities to interact directly with scientists aboard different vessels. This initiative was designed to inspire students to pursue careers in the Science Technology Engineering Math (STEM) fields, and will provide unprecedented access to deep-sea explorations.

The program will commence with the Exploration Vessel Nautilus' six-month expedition in the Gulf of Mexico and Caribbean Sea, where researchers will investigate active undersea volcanoes and study the impact of the 2010 Deepwater Horizon oil spill.

The Navy continues to invest in the future of today's youth. The Department of the Navy and City of Chicago started the Critical MASS (Midwest Association for Science and Service) program to provide high school and community college students an intense, hands-on experience in (STEM) education. This five-year, $2 million campaign will bring enrichment programs to seven Chicago high schools driven by STEM courses.

Business Transformation

The DON is committed to transforming the way it does business by using our people, processes, and systems more effectively. The DON FIAR plan is the integrating financial element of the DON's business transformation strategy and a supporting initiative of the DoD FIAR plan, which organizes and prioritizes the audit readiness and financial improvement efforts of DoD Components. Audit readiness is a goal of business transformation and a key metric for measuring its success and progress. Navy ERP is the key system driver of our business transformation and a key enabler of the DoD Enterprise Transition Plan which organizes and prioritizes efforts to modernize DoD business and financial systems. Continuous Process Improvement/Lean Six Sigma (CPI/LSS) initiatives, part of the DoD-wide CPI/LSS program, enable more effective and efficient operations across the DON enterprise.

The DON Financial Improvement and Audit Readiness (FIAR) Program

The DON Financial Improvement and Audit Readiness (FIAR) Program and the Marine Corps Financial Improvement and Audit Readiness Initiative are multi-year, Department-wide efforts to modernize Navy-Marine Corps financial processes and systems to better serve worldwide operations. The goal of our financial improvement and audit readiness efforts is to produce more timely financial management information with greater accuracy, reliability, and accessibility. With improved information, we can allocate the DON

resources in a more precise way and move closer to producing auditable DON-wide financial statements.

Our FIAR efforts align with the new priorities and associated strategy established by the Under Secretary of Defense (Comptroller) for bringing DoD into a state of financial audit readiness and in compliance with the Chief Financial Officers Act of 1990 (as amended). These priorities focus on improving processes, controls, and systems that support information most often used and relied upon by both civilian and military leaders in daily business operations—budgetary information, as reported on the Statement of Budgetary Resources (SBR), and mission critical asset information, such as military equipment and real property, as reported on the Balance Sheet. These priorities demonstrate the value of these financial statements to our daily business operations, particularly for funds control and resource utilization.

The DON has asserted that the Major Defense Acquisition Program (MDAP), the Department of the Navy (DON) Transportation of People (TOP), Civilian Pay (CIVPAY), Reimbursable Work Orders Grantor and Performer (RWO G/P), Military Pay, and Funds Balance with Treasury (FBWT) segments are audit ready. For FY 2014 the Navy Office of Financial Operations (FMO) is on target to assert Contract Vendor Pay (CVP), Financial Statement Compilation and Reporting (FSCR), and MILSTRIPs.

For the DON's Existence and Completeness (E&C) efforts, we received unqualified opinions on our ships, submarines, intercontinental ballistic missiles, satellites, and aircraft in FY 2012. The DON reasserted ordnance and asserted Navy Small Boats in FY 2013. The DON expects to assert Uninstalled Aircraft Engines (UAE), Equipment, and Inventory in FY 2014. Validation for UAE is expected to be completed in FY 2014, with the remaining assertions validated in FY 2015.

Audit Response and Evaluation

To continue and sustain successes in audit readiness, the DON has created and staffed the Audit Response and Evaluation Division. Building on the DON's success of the Audit Response Center (ARC), and decentralizing Budget Submitting Office support to regional offices, the Audit Response and Evaluation effort ensures continued emphasis on the gains achieved in preparing the DON for full SBR audit. Combining the near term responsibilities for audit readiness with long-term evaluations and audit sustainment, this the DON function coordinates and oversees enterprise-wide audit sustainment activities through the development and management of a comprehensive evaluation program that supports future audits and examination efforts.

Marines fire a shoulder-launched, multipurpose assault weapon as part of a movement-to-contact training evolution. (Photo by Sgt. Sarah Fiocco)

Marine Corps Financial Improvement and Audit Readiness Initiative

By means of an independent study, the DON analyzed the value of the Marine Corps effort to pursue financial audit readiness in terms of the bottom line impact for improving the efficiency and effectiveness of their financial processes and controls. This impact was measured in terms of the direct return for every dollar appropriated by Congress. The results of this analysis showed that for every dollar invested, nearly three dollars in value were created and that the resulting economies translated directly into the Marine Corps having the capability to purchase more mission supportive weapons for the same amount of appropriated resources. In the future, the DON will use this return on investment metric as a guide as it implements the substantial lessons learned from the ongoing Marine Corps audit experience to the Navy.

Navy Enterprise Resource Planning

Navy Enterprise Resource Planning (Navy ERP) is an integrated business management system that unifies, standardizes, and streamlines Navy business operations. It has replaced multiple older, more costly information systems, with data managed in a single system, providing financial transparency to just over half of the Navy's Total Obligational Authority. Commands that implemented Navy ERP have realized measurable improvements in accuracy, timeliness, and accessibility of information and

efficiencies in business and reporting processes. Navy ERP continues to drive enterprise-wide business process efficiencies and provides financial transparency and total asset visibility through business process and data standardization efforts; it will be a major positive force contributing toward Navy's financial audit readiness.

The Navy ERP system Acquisition and Financial Management functionality has been operational since October 2007, and today includes the following commands, serving over 71,000 users: Naval Air Systems Command, Naval Supply Systems Command, Naval Sea Systems Command (Department of the Navy and Navy Working Capital Fund operations), Space and Naval Warfare Systems Command, Office of Naval Research and Strategic Systems Programs.

The Navy deployed the Single Supply Solution, which consolidates wholesale and retail supply functions. This functionality is directly benefiting the Navy warfighter through improved inventory management, with the ability to quickly locate parts anywhere in the world and get them to the warfighter in record time. With inventory enterprise visibility, the Navy is achieving significant savings through more effective use of existing global inventory.

This year the Navy Enterprise Resource Planning (ERP) business process financial information team from Program Executive Office Enterprise Information Systems received the Admiral Stanley R. Arthur Award for logistics excellence as the Acquisition Logistics Team of the Year. This Navy ERP team was recognized for innovation and leadership in standardizing Navy business processes, made major contributions to enterprise financial audit readiness, and successfully supported and materially advanced the Navy's logistics mission.

The team worked to materially improve end-to-end business processes and overall financial audit readiness, by providing visibility of inventory and the financial audit trail.

Transparency in financial accounting allows the Navy to make information-based decisions, more effectively and efficiently plan and execute missions, and to meet statutory audit readiness requirements.

Navy ERP is the first Navy financial system to undergo a Federal Information System Controls Audit Manual (FISCAM) review in support of financial improvement audit readiness.

More information on Navy ERP is available at *http://www.erp.navy.mil*.

Continuous Process Improvement

Continuous Process Improvement (CPI) is a primary enabler for managing the effectiveness and efficiency of our processes in support of the warfighter and business operations, and a critical path toward financial audit readiness. CPI provides our workforce with proven performance improvement tools, such as Lean/Six Sigma and Audit Readiness Training Symposiums, to build a strong warfighter support foundation for improving cycle time and reliability, aligning the work of subordinate organizations to enterprise-wide goals, and optimizing costs. Under the purview of the Deputy Under Secretary of the Navy for Business Operations and Transformation, we are bringing together processes and organizations for the accomplishment of strategic and corporate business objectives.

During fiscal year 2013, Sailors and Marines looking for answers on the deployment of continuous process improvement (CPI) in the Naval Aviation Enterprise (NAE) received a one-stop resource. The NAE CPI Guidebook describes and clarifies roles, responsibilities, standards, and proven methods that aid the NAE to assess and improve the performance of its organizations. It also provides standard, solution-oriented, problem-solving methods and concepts that enable personnel to continuously improve performance, maximize the effective use of resources, and move organizations toward the achievement of the strategic goals of the NAE.

SYSTEMS, CONTROLS AND LEGAL COMPLIANCE

Commanders and managers throughout the DON must ensure the integrity of their programs and operations. Part of this responsibility entails compliance with Federal requirements for financial reporting, financial management systems, and internal controls, such as the Federal Financial Management Improvement Act (FFMIA) and the Federal Managers' Financial Integrity Act (FMFIA). These requirements promote the production of more timely, reliable, and accessible financial information, supported by the development and implementation of more effective internal controls. More useful financial information and effective controls save money and improve efficiency, thereby enhancing public confidence in our stewardship of public resources, which is critical for the protection and sustainment of our nation and vital U.S. interests.

Included in this section is the management assurance letter which provides management's assessment of

the effectiveness of the DON's internal controls in conjunction with FFMIA and FMFIA. This section also provides the DON's detailed assessment of the DON's internal controls over non-financial operations, financial reporting, acquisition and financial systems.

Management Assurances

The objectives of the systems of internal accounting and administrative control of the DON are to provide reasonable assurance that:

- Obligations and costs are in compliance with applicable laws;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Applicable revenues and expenditures are properly recorded and accounted for, to permit the preparation of reliable accounting, financial and statistical reports and to maintain accountability over the assets.

Internal Control Over Non-Financial Operations

The DON Managers' Internal Control (MIC) Program is the administrative vehicle for monitoring the Department's systems of internal control by evaluating and maintaining sufficient documentation to support its evaluation and level of assurance. The MIC Program is decentralized and encompasses both shore Commands and afloat forces. The evaluation of internal control extends to every responsibility and activity undertaken by the DON and applies to program, administrative, and operational controls.

Primary responsibility for program execution and reporting resides within a network of 19 Major Assessable Units (MAUs), which include the Assistant Secretaries of the Navy, the Chief of Naval Operations (CNO), the Commandant of the Marine Corps (CMC), Secretariat Staff Offices and other entities that report directly to the SECNAV or UNSECNAV. The DON MAUs receive internal control certification statements from their subordinate units, and in turn provide the UNSECNAV with their annual FMFIA Certification Statements. The signed certification statements are used as the primary source documents for the SECNAV's determination of reasonable assurance over the effectiveness of the Department's system of internal control.

Complementing the self-reporting of control deficiencies, the DON's Auditor General, in collaboration with the Deputy Assistant Secretary of the Navy, Financial Operations (DASN (FO)), reviews audit reports from the Government Accountability Office (GAO), the Department of Defense (DoD) Inspector General and the Naval Audit Service (NAVAUDSVC). This review helps identify control deficiencies and utilizes a systematic methodology to determine materiality. The high degree of collaboration and communication between the DASN (FO) Manager's Internal Control Program (MICP) administrators and the NAVAUDSVC has resulted in a consistent and comprehensive perspective on the DON's internal control posture.

OUTSTANDING MATERIAL WEAKNESS FY 2013

INTERNAL CONTROL REPORTING CATEGORY	MATERIAL WEAKNESS	TARGET CORRECTION YEAR
Contract Administration	Service Contracts	FY 2015
Acquisition	Attenuating Hazardous Noise in Acquisition & Weapon System Design	FY 2015
Communications/ Intelligence/Security	Management of Communications Security (COMSEC) Equipment	FY 2014
Communications/ Intelligence/Security	Safeguarding Personally Identifiable Information (PII)	FY 2014
Procurement/ Contract Administration	Effective Use of Earned Value Management (EVM) Across Shipbuilding Programs	FY 2014

In addition to the operational assessments described above, the DON MIC program includes a separate assessment of Internal Control over Financial Reporting (ICOFR) and Internal Control over Financial Systems (ICOFS).

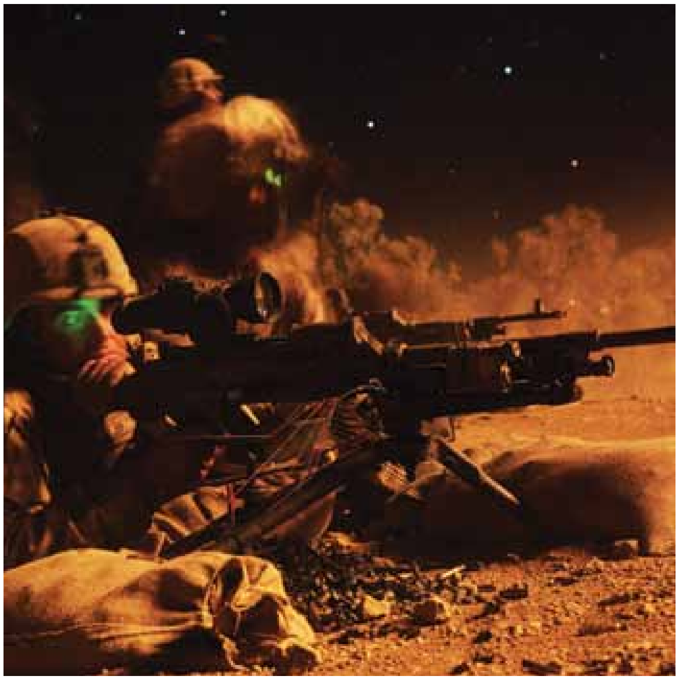
Internal Control Over Financial Reporting (ICOFR)

The DON continues to implement processes to reach a status of full compliance with Office of Management and Budget (OMB) Circular A-123, Appendix A in conjunction with overall Navy and Marine Corps audit readiness efforts under the DoD FIAR. The DON's current focus is on achieving the FIAR objectives relative to budgetary information and mission critical asset information priorities. Through the DON FIAR discovery process, the DON continues to work closely with participating Commands and service providers, such as the Defense Finance and Accounting Service (DFAS), to identify,

evaluate and document the risks and internal controls associated with the end-to-end business processes underlying the financial statements. Attention is focused on remediating material weaknesses that will allow for overall achievement of the DON's assertion goals.

Through the DON FIAR discovery process, documentation efforts continue as the DON moves toward its objective of asserting audit readiness over all financial reporting segments. In FY 2013, we identified:

- 18 material weaknesses in Existence and Completeness, Reimbursable Work Orders – Grantor and Performer, Contract Vendor Pay, Financial Statement Compilation and Reporting, Military Standard Requisitioning and Issue Procedures, and Transportation of Things.
- 1 Nonconformance with Financial Systems.
- 3 Corrected Material Weaknesses/ Nonconformances, including Fund Balance with Treasury, Reimbursable Work Orders – Grantor and Performer (with the exception of the following processes: Post Collection and Post Disbursement Validation, Year-End Accrual, Triennial Review, and Trading Partner Number Reconciliation), and Transportation of People.



Marines engage a simulated enemy force with an M240B machine gun at Bradshaw Training Area in Northern Territory, Australia. (Photo by Sgt. Sarah Fiocco)

In FY 2014, FMO plans further discovery and development of corrective actions plans with executable tasks to mitigate the material weaknesses.

The Marine Corps continued improving the documentation of specified business processes to assist stakeholders and auditors in obtaining an understanding of financial processes used by the Marine Corps. Revised descriptions are used to identify controls and key controls to test. The Marine Corps ICOFR program aims to support the DON FIAR objectives by targeting specific evaluations that strengthen the integrated objectives of the DON SBR assertion. For FY 2013, the Marine Corps reported material weaknesses in Military Equipment, Real Property, and Contracts. Efforts are underway to address these material weaknesses via formal corrective action plans pending additional analyses and concurrence by the Marine Corps Senior Assessment Team.

Internal Control Over Financial Systems (ICOFS)

The DON understands ICOFS plays a key role in the generation of the DON financial statements. The DON implemented a strategy for identifying and prioritizing assessment of financial and mixed systems. Over two hundred systems are utilized to support Navy's complete set of financial statements. Once a system was identified as audit relevant or critical to the segment assertion package, the DON worked with the segment managers to collect additional data points that would affect the assessment scope, approach, and timeline.

The DON conducted FISCAM assessments on select information technology systems and coordinated with service providers such as DFAS, Defense Logistics Agency (DLA), and Defense Contract Management Agency (DCMA) to identify and prioritize feeder system assessments. The DON refined its strategy for assessing Legacy and Enterprise Resource Planning (ERP) system controls. The DON prioritized IT controls based on FISCAM and FIAR guidance to ensure financial data integrity and reliability. For FY 2013, the DON tracked, updated, and managed identified systems to support the Office of Under Secretary of Defense, Comptroller (OUSD (C)) FIAR identified business segments and financial reporting framework.

Below is the management assurance letter for FY 2013.

THE SECRETARY OF THE NAVY
WASHINGTON DC 20350-1000

NOV 19 2013

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act

As the Secretary of the Navy, I recognize that the Department of the Navy (DON) is responsible for establishing and maintaining effective internal management controls to meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). Tab A provides specific information on how the DON conducted the assessment of Operational Internal Controls, in accordance with the Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Controls, and provides a summary of the significant accomplishments and actions taken to improve the DON's internal controls during the past year.

I am able to provide qualified statement of assurance that operational and administrative internal controls of the DON meet the objectives of FMFIA, with the exception of five unresolved material weaknesses described in Tab B. These weaknesses were found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations, as of the date of this memorandum. With an exception of the enclosed material weaknesses, the internal controls were operating effectively.

The DON conducted its assessment of the effectiveness of internal controls over financial reporting in accordance with OMB Circular A-123, Appendix A, *Internal Control Over Financial Reporting*. Tab A provides specific information on how the DON conducted this assessment. Based on the results of this assessment, the DON is able to provide a qualified statement of assurance that the internal controls over financial reporting as of 30 June 2013 were operating effectively with the exception of 22 material weaknesses noted in Tab C.

The DON also conducted an internal review of the effectiveness of the internal controls over financial systems. Tab A provides specific information on how the DON conducted this assessment. Based on the results of this assessment, the DON is able to provide a qualified statement of assurance that the internal controls over the financial systems as of 30 June 2013, are in compliance with the Federal Financial Management Improvement Act and OMB Circular A-127, *Financial Management Systems* with the exception of one nonconformance noted in Tab C.

My point of contact is Ms. Erica Gaddy. She may be reached at (202) 685-0791 or erica.gaddy@navy.mil

Sean J. Stackley
Acting

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The accompanying financial statements and related disclosures represent our enduring commitment to fiscal accountability and transparency. Through our FIAR plan and related business transformation initiatives discussed earlier, we have made significant progress toward improving the quality and timeliness of our financial information. However, we are currently unable to fully implement all elements of U.S. generally accepted accounting principles and OMB Circular A-136, "Financial Reporting Requirements," due to limitations of our financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the DoD, Office of Inspector General, was unable to express an opinion on our FY 2013 financial statements. It should be noted that these limitations exist primarily in our proprietary accounting processes and less so in the budgetary accounting performed to manage and report on the application of budget authority to the purposes and programs approved in appropriations acts. In fact, the U.S. Marine Corps achieved full audit readiness for its SBR and the DON revised its strategy to place first priority on its SBR as well. Despite documented material weaknesses we believe the budgetary information used for decision-making is accurate and reliable because of compensating measures and close oversight.

For financial reporting purposes, we are organized into two reporting entities: The DON and Navy Working Capital Fund (NWCF), which include financial information for both the U.S. Navy and the USMC. Each reporting entity has a separate set of financial statements and related disclosures.

The DON

The DON supports overall Departmental operations. Enacted appropriations comprise the majority of the account structure, which includes five major appropriation groups:

- Operation and Maintenance
- Military Personnel
- Procurement
- Research, Development, Test, and Evaluation
- Military Construction

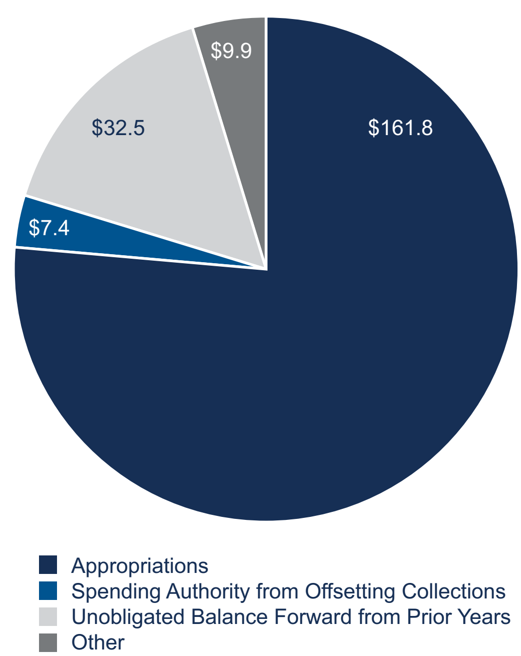
Enacted appropriations flow through OMB and the Office of the Secretary of Defense to the Office of the Secretary of the Navy, where they are allocated to administering offices and commands. The administering offices and commands, which in turn obligate the appropriations to fund operational expenses and capital investments, are required to exercise a system of effective control over financial operations.

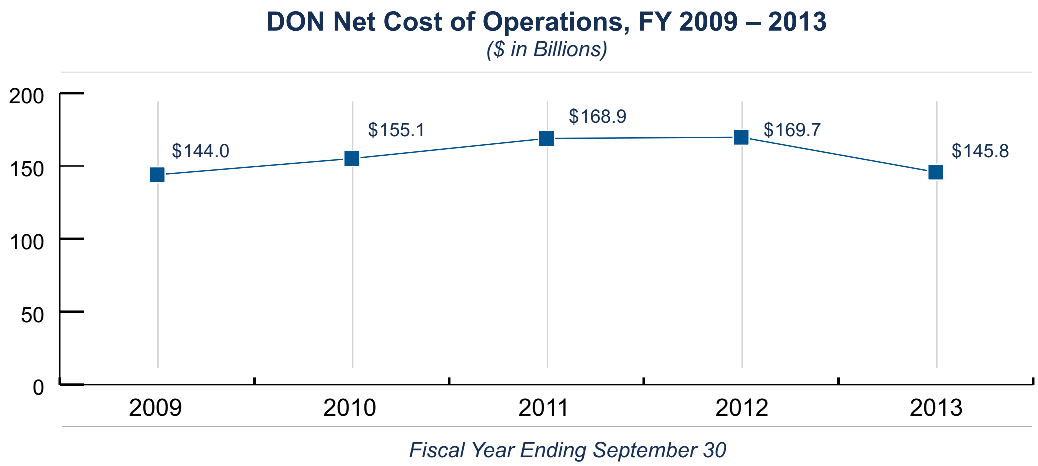
Results of Operations

The Combined SBR presents total budgetary resources of $211.7 billion that were available to the DON during FY 2013 and the status of those resources at fiscal year-end. Total budgetary resources were down $15.1 billion, a 7.1 percent decrease in FY 2013 compared to FY 2012. The enacted appropriations of $161.8 billion represent 76.5 percent of total budgetary resources and decreased $11.6 billion compared to FY 2012. The majority of this decrease was with respect to military construction. Additionally, the decrease in total budgetary resources is attributable to the $32.5 billion unobligated balance brought forward from the prior year, which comprised 14.3 percent of total budgetary resources and decreased $656.2 million compared to FY 2012. The majority of the decrease in unobligated balance brought forward was in the Procurement appropriation accounts. The DON obligated $178.3 billion of the $211.7 billion total resources in FY 2013, which is a decrease of $15.8 billion or 8.1% compared to FY 2012. The Consolidated Statement of Net Cost presents net cost of operations of $145.6 billion during FY 2013. Net cost of operations represents gross costs incurred by the DON less earned revenue. Net cost of operations decreased $24.1 billion, which represents a 16.5 percent decrease over FY 2012.

DON Sources of Funds, FY 2013

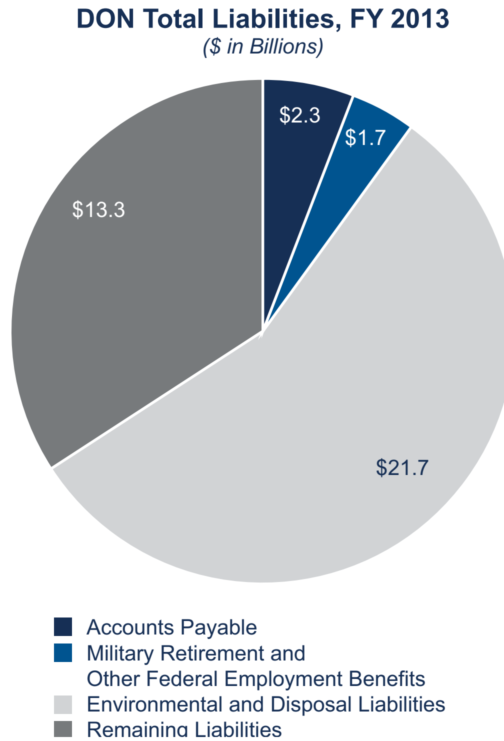
($ in Billions)

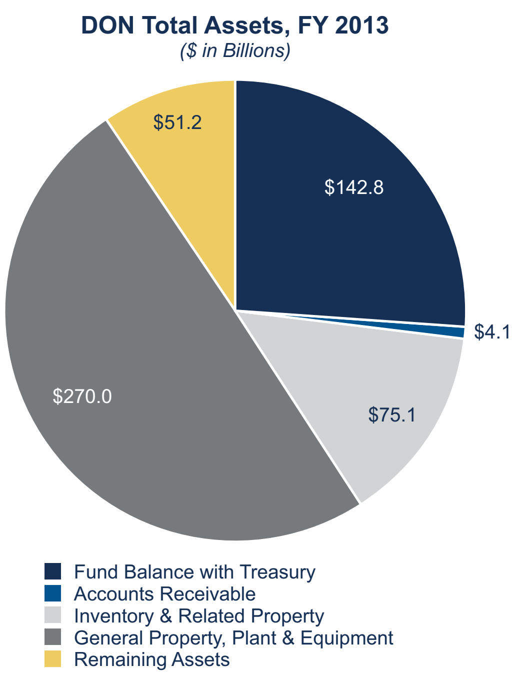




Financial Position

The DON continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. As of 30 September 2013, net position totaled $504.4 billion, which represents a $51.3 billion or 11.3 percent increase from FY 2012. The overall increase in net position is attributed to increases of $54.4 billion and $1.1 billion in total assets and total liabilities, respectively.





Navy Working Capital Fund

NWCF is a revolving fund established to meet the diverse requirements of the Navy and Marine Corps operating forces. Under the revolving fund concept, an appropriation or a transfer of funds finances initial NWCF operations. General or appropriated fund payments from customers for goods delivered or services performed subsequently replenish this initial working capital investment and sustain a continuous cycle of operations, minimizing the need for additional annual appropriations by Congress. The goal of NWCF is to break even over time by matching revenues earned to costs incurred. Achievement of this goal is occasionally complicated by the requirement that NWCF business areas maintain stable budget-driven prices for goods and services, to protect customers from unforeseen price fluctuations.

NAVY WORKING CAPITAL FUND BUSINESS ACTIVITIES BY BUSINESS AREA

SUPPLY MANAGEMENT	BASE SUPPORT	RESEARCH AND DEVELOPMENT
Supply Management, Navy *(https://www.navsup.navy.mil)* Supply Management, Marine Corps *(http://www.logcom.usmc.mil)* **DEPOT MAINTENANCE** Depot Maintenance, Aviation *(http://www.navair.navy.mil)* Depot Maintenance, Marine Corps *(http://www.logcom.usmc.mil)*	Facilities Engineering Commands *(https://portal.navfac.navy.mil)* Naval Facilities Engineering Service Center *(https://portal.navfac.navy.mil)* **TRANSPORTATION** Military Sealift Command *(http://www.msc.navy.mil)*	Naval Research Laboratory* *(http://www.nrl.navy.mil)* Naval Surface Warfare Center *(http://www.navsea.navy.mil)* Naval Undersea Warfare Center *(http://www.navsea.navy.mil)* Naval Air Warfare Center *(http://www.navair.navy.mil)* Space and Naval Warfare Systems Centers *(http://spawar.navy.mil)*

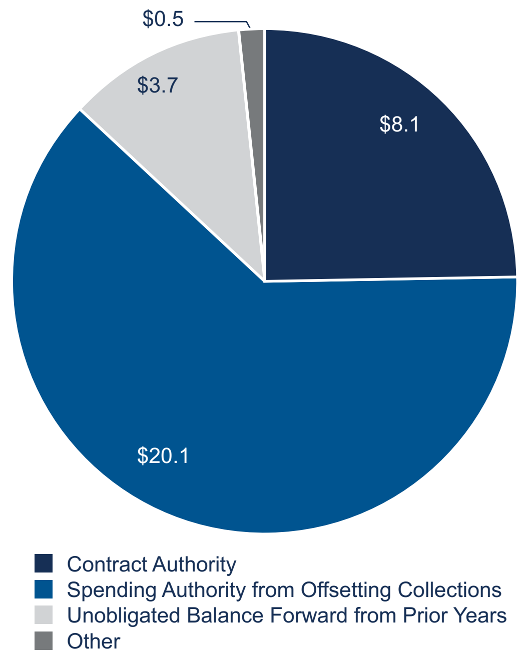
*Also see Office of Naval Research *(http://www.onr.navy.mil)*

Results of Operations

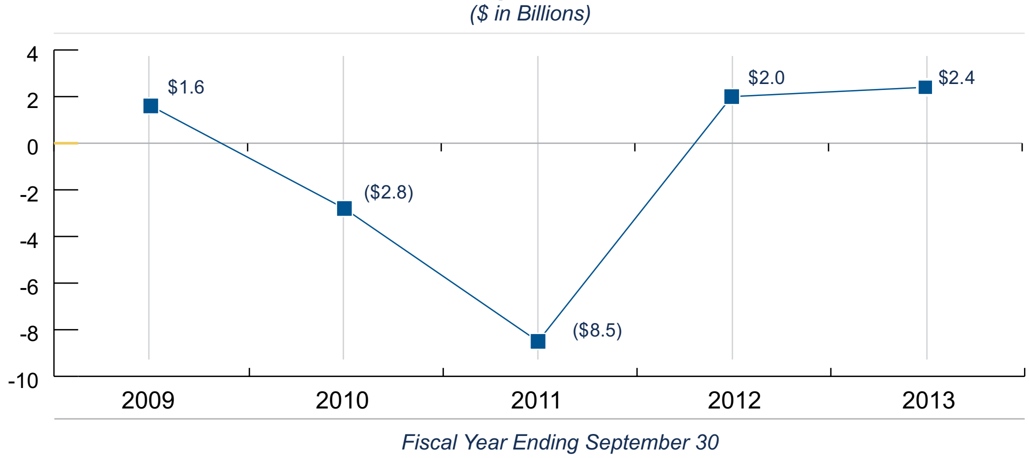
The Combined SBR presents total budgetary resources of $32.5 billion that were available to NWCF during FY 2013 and the status of those resources at fiscal year-end. Total budgetary resources decreased $1.7 billion, which was a 4.9% decrease over FY 2012. NWCF budget authority is comprised of contract authority and spending authority from offsetting collections of which the latter accounts for 61.9% of total budgetary resources. The majority of the decrease in overall budget authority is due to a $1.6 billion decrease in Spending Authority from Offsetting Collections in FY 2013. NWCF business activities obligated $28.9 billion of the $32.5 billion total resources in FY 2013 which represents a decrease of $1.6 billion or 5.2% over FY 2012.

The Consolidated Statement of Net Cost presents net cost of operations of $2.4 billion during FY 2013. Net cost of operations represents gross costs incurred by NWCF less earned revenue. Sources of earned revenue include the DON; Army and Air Force General Funds; Defense Working Capital Funds; other Navy and DoD appropriations; and non-DoD fund sources. The Navy had an increase of $0.3 billion in net costs in FY 2013 over FY 2012, which results in a positive net cost of operations.

NWCF Sources of Funds, FY 2013
($ in Billions)

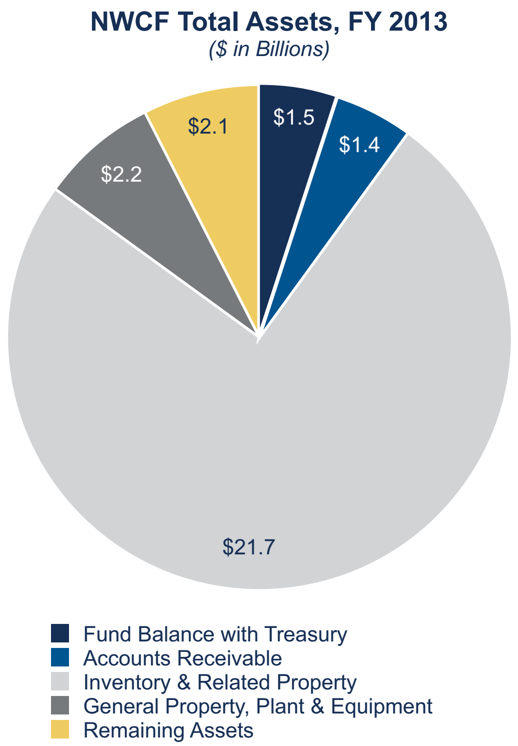


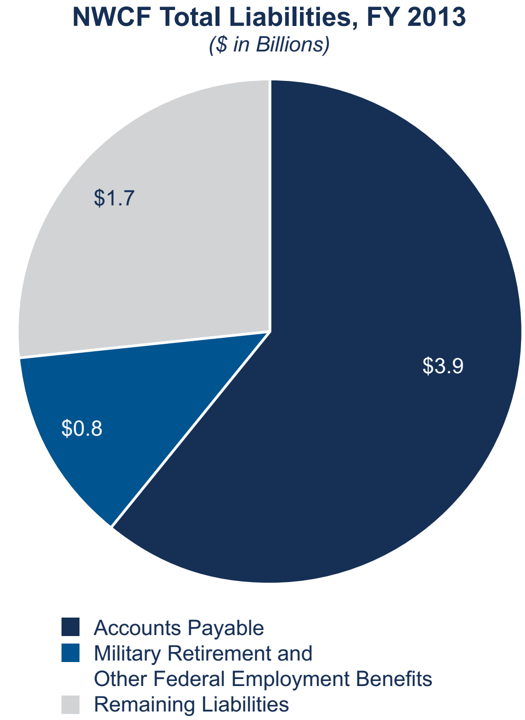
NWCF Net Cost of Operations, FY 2009 – 2013
($ in Billions)



Financial Position

The NWCF continued to report a positive net position in its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. As of 30 September 2013, net position totaled $22.4 billion, which represents an increase of $1.3 billion and a 6.4 percent increase from FY 2012. An increase of $2 billion in total assets and $0.6 billion in total liabilities contributed to the overall increase in net position.

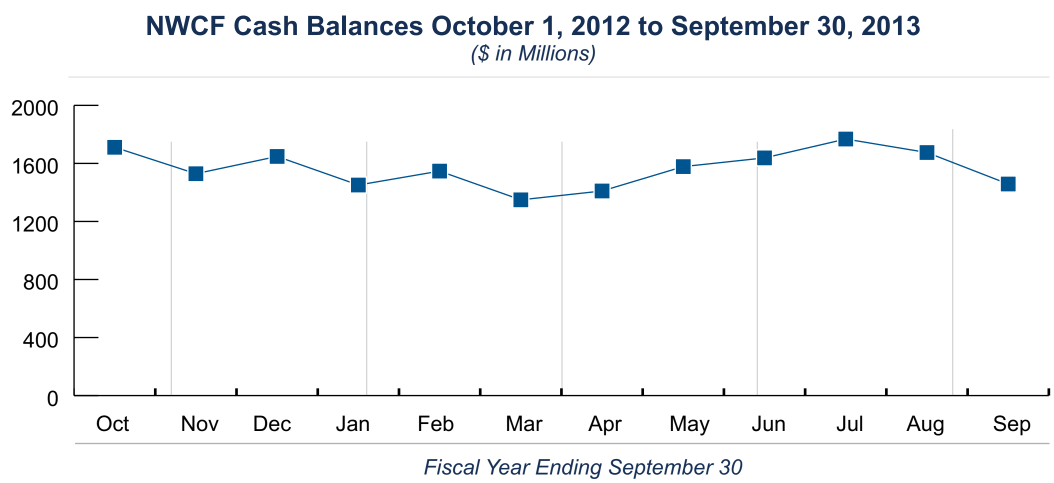




Cash Management

The NWCF manages working capital fund cash at the Departmental level. It must maintain cash levels at seven to ten days of operational costs, plus have sufficient cash reserves to meet six months of projected capital outlays, as required by the DoD Financial Management Regulation.

For FY 2013, the seven-day cash requirement was $889.9 million and the ten-day requirement was $1.2 billion.



Manning the rails of an amphibious dock landing ship. (U.S. Navy Photo by Mass Communication Specialist 3rd Class Samantha J. Webb/Released)

LOOKING FORWARD

The DON's achievements during FY 2013 established a firm foundation that will assure future success in executing the mission of the Navy and Marine Corps, and building a sound business operating environment. In FY 2014, the Navy will focus on achieving the DON's objectives outlined in the Strategic Management section. Of those objectives, the priority is to preserve pay and benefits for Sailors, Marines, and their families, train the workforce, maintain equipment, and help build fleet forces for the future.

Operating in a Fiscally-Driven Frontier

The Fiscal Year 2014 President's Budget reflects a strategic direction grounded in the reality of the nation's fiscal challenges. These decisions encompass the extraordinary circumstances the Navy is faced with daily as result of constrained resources.

The Navy must continue to invest in future weapons systems, vehicles, and infrastructure, and scrutinize every option to provide for the most affordable and effective solution. The FY 2014 Budget provides for construction of forty-one new vessels over the Future Years Defense Program.

The Navy and Marine Corps are agile and flexible expeditionary forces engaged in a full range of operations around the world. Today over 42,000 Navy personnel, 20,000 Marines, and 121 ships are underway or deployed worldwide creating a safer, more stable, and more prosperous world for the American people, the nation's allies, and its partners. The Department's global security effort maintains a balance of presence between the Asia-Pacific and Middle East regions.

Allies such as the United Kingdom and Germany will remain some of the Navy's principal partners in seeking global and economic security for the foreseeable future. Building partnerships elsewhere is also important to protect freedom of access throughout the world. Through partnerships with a growing number of nations, including those in Africa and Latin America, the Navy strives for a common vision of freedom, stability, and prosperity.

This focused balance of global efforts using innovative, lower cost and smaller footprint approaches with partners and allies can be attributed to the extraordinary service and sacrifice of our Sailors and Marines. Through their efforts, the Navy-Marine Corps team has helped to end the war in Iraq, put al-Qa'ida on the path to defeat, and has made significant progress in stabilizing Afghanistan, affording the opportunity to begin the transition of forces out of Afghanistan.

The Navy continues to impose local sea control, sustain power ashore and play a major strategic role in the Persian Gulf, Horn of Africa and Afghanistan by providing critical force protection requirements, training, equipment, and assistance to the Navy's coalition partners.

Taking Care of Our People

The Department of the Navy is committed to maintaining the finest, highest quality naval force that supports the new strategic guidance for DoD. Its people are a critical component of the Department's Maritime Strategy. America's naval forces are and will remain combat-ready because of the dedication and motivation of Sailors, Marines, and the civilian workforce. The development and retention of quality personnel are vital to meeting the defense strategy goal to be a smaller, leaner, more agile, flexible, ready, and technologically-advanced all-volunteer force. The DON will take care of the total volunteer force by sustaining quality of service/quality of life programs, including training, promotion opportunities, health care, housing, and reasonable operational and personnel tempo.

Maintaining Warfighter Readiness in an Era of Reduced Budgets

The Department will maintain strong, agile and capable military forces. The security environment today has created new challenges for naval forces, including support demands for security, stabilization, transition and reconstruction operations, support for homeland security, and continued preparedness for contingency operations. The evolving dynamics of the 21st-century security environment require our forces to be ready to deploy globally.

The top readiness priority is ensuring that forces are fully trained, ready to deploy, and fully supported while deployed. The budget reflects the best balance of resources to achieve this priority. The Navy will closely manage the readiness accounts to ensure we can fulfill all existing, enduring, and emerging warfighting requirements.

Investing Toward the Joint Force of 2020

The Department of the Navy is dedicated to procuring a naval force that is both affordable and meets the priorities of our nation. The Navy's forces will remain sea based,

with global speed and persistence provided by forward deployed forces and supplemented by rapidly deployable forces. The Navy will further provide both actionable intelligence and the ability to take action where and when the threat is identified in today's unstable environment.

Revitalizing the Force Ashore

Providing Sailors, Marines, and the Department's civilians with high quality facilities, information technology, and an environment to achieve their goals is fundamental to mission accomplishment. The ability to project power through forward deployed naval forces relies heavily on a strong and efficient shore infrastructure.

Driving Innovative Enterprise Transformation

The Department of the Navy continues its commitment to building a performance based culture and has actively developed process improvements to improve and measure performance. Working in cooperation with the DoD enterprise, the Navy will continue to improve performance measurement and budget reporting and to strengthen links between performance and budget.

The DON continues to develop its vision for Business Transformation. Because of the size and complexity of the DON's business operations it is imperative that the Navy-Marine Corps team continues to change its business practices to be more agile, efficient, and increasingly responsive to the warfighter.

In these times of fiscal constraint, the DON is challenged to make necessary investments in future capabilities while sustaining current warfighting effectiveness.

The DON business process improvement involves executing, aligning and integrating a series of enterprise-wide initiatives which will dramatically transform our ability to execute programs and support our mission. The result will be improved efficiency, better decision-making, and an organizational culture that is performance-based. Collectively, these initiatives will create an environment that produces more accurate and timely business information and will, over time, be endorsed by a favorable third party financial audit.

The Department of the Navy continues to look at ways that will best position itself to be prepared to defend the country and complete its mission despite domestic budget shortages and international unrest.

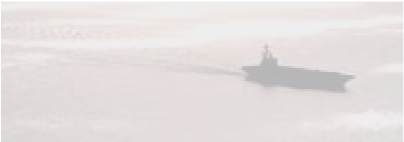
Newly commissioned officers celebrate their new positions by throwing their Midshipmen covers into the air as part of the U.S. Naval Academy class of 2013 graduation and commissioning ceremony. (U.S. Navy photo by Chief Mass Communication Specialist Sam Shavers/Released)

LIMITATIONS TO THE FINANCIAL STATEMENTS

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles for Federal entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Department of the Navy Fiscal Year 2013 Annual Financial Report

Audit Opinions



Protecting Freedom Under Extraordinary Circumstances

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

December 9, 2013

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Department of the Navy General Fund FY 2013 and FY 2012 Basic Financial Statements (Report No. DODIG-2014-014)

Report on the Basic Financial Statements

The Chief Financial Officers Act of 1990, as amended, requires the DoD Inspector General to audit the accompanying Department of the Navy General Fund Consolidated Balance Sheet as of September 30, 2013 and 2012, and the related Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and notes to the basic financial statements.

Management's Responsibility for the Annual Financial Statements

The annual financial statements are the responsibility of Department of the Navy management. Management is responsible for (1) preparing basic financial statements that conform with generally accepted accounting principles in the United States (U.S. GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that they met broad control objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA); (3) ensuring that the Department of the Navy's financial management systems fully comply with Federal Financial Management Improvement Act of 1996 (FFMIA) requirements; and (4) complying with applicable laws and regulations.

Auditor's Responsibility

Our responsibility is to express an opinion on the basic financial statements based on conducting the audit in accordance with U.S. generally accepted government auditing standards and the Office of Management and Budget (OMB) Bulletin 14-02,

"Audit Requirements for Federal Financial Statements," October 21, 2013. Based on the matters described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Section 1008(d) of the FY 2002 National Defense Authorization Act limits the DoD Inspector General to performing only those audit procedures required by U.S generally accepted auditing standards that are consistent with the representations made by management. Department of the Navy management asserted to us that the Department of the Navy General Fund FY 2013 and FY 2012 Basic Financial Statements would not substantially conform to U.S. GAAP and that Department of the Navy financial management and feeder systems could not adequately support material amounts on the basic financial statements as of September 30, 2013. Accordingly, we did not perform all the auditing procedures required by U.S. generally accepted government auditing standards and OMB Bulletin 14-02, to determine whether material amounts on the basic financial statements were presented fairly. We considered the scope limitation in forming our conclusions on the basic financial statements.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we could not obtain sufficient evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Department of the Navy General Fund FY 2013 and FY 2012 Basic Financial Statements. Thus, the basic financial statements may have undetected misstatements that are both material and pervasive.

Other Information in the Annual Financial Statements

We performed our audit to form an opinion on the basic financial statements as a whole. The Department of the Navy presented the Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Information for additional analysis as part of the basic financial statements; these elements are not required parts of the basic financial statements. Based on our limited review, we did not find any material inconsistencies between the other information and the basic financial statements and applicable sections of OMB Circular No. A-136 (Revised),

"Financial Reporting Requirements," October 21, 2013, and DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6b, "Form and Content of DoD Audited Financial Statements" April 2013.

Report on Other Legal and Regulatory Requirements, Contracts, and Grant Agreements

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have a direct and material effect on the basic financial statements and with OMB regulations and audit requirements for financial reporting because management represented that instances of noncompliance identified in prior audits still exist. Therefore, we did not determine whether the Department of the Navy complied with all applicable laws and regulations, contracts, and grant agreements related to financial reporting. Providing an opinion on internal control and compliance with certain provisions of laws and regulations, contracts, and grant agreements was not an objective of our audit, and accordingly, we do not express such an opinion.

See attachment for additional details on internal control and compliance with legal and other regulatory requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to the Department of the Navy. However, management did not provide comments.

This report is intended solely for the information and use of Department of the Navy management, the DoD Office of the Inspector General, OMB, the U.S. Government Accountability Office, and U.S. Congress, and is not intended to be used, and should not be used, by anyone other than these specified parties.

Lorin T. Venable

Lorin T. Venable, CPA
Assistant Inspector General
Financial Management and Reporting

Attachment: As stated

Report on Internal Control Over Financial Reporting

Internal Control Compliance

In planning our work, we considered the Department of the Navy's internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances for the purposes of expressing our opinion on the basic financial statements but not appropriate to the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on internal control over financial reporting.

Management Responsibilities

Management is responsible for implementing and maintaining effective internal control to include providing reasonable assurance that Department of the Navy personnel accumulated, recorded, and reported accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

Auditor's Responsibilities

Our purpose was not to express an opinion on internal control over financial reporting, and we do not do so. However, the following material weaknesses could adversely affect the Department of the Navy's financial operations.

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continued in the following areas. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's basic financial statements will not be prevented, or detected and corrected on a timely basis.

Financial Management Systems. The Department of the Navy's financial management and feeder systems do not comply with Federal financial management system requirements, U.S. GAAP, and U.S. Government Standard General Ledger (USSGL).

Attachment
Page **1** of **5**

Financial Reporting of Collections and Disbursements

Fund Balance With Treasury. Deficiencies associated with Fund Balance with Treasury include undistributed disbursements, collections, and abnormal balances and the inability to reconcile the Department of the Navy General Fund records with the Department of the Treasury records and the Statement of Budgetary Resources.

Problem Disbursements. Inaccurate or missing accounting data have resulted in unmatched disbursements and collections and an inability to reconcile the Department of the Navy General Fund records with the Department of the Treasury records.

Unobligated Balances. Deficiencies exist in recorded unobligated amounts because financial systems are not fully integrated, and not all commands sufficiently review unliquidated obligations. Additionally, reimbursable transactions are not properly documented or reported on the Disbursing Officer Statement of Accountability.

Financial Reporting of Plan to Perform/Order to Cash. There are two deficiencies associated with the Accounts Receivable line. Audit trails are inadequate, and the accounts receivable sub-ledgers do not reconcile with the general ledger.

Financial Reporting of Operating Materials and Supplies. Legacy systems do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property." In addition, completeness issues exist because the legacy systems were not designed to provide the value of Operating Materials and Supplies using the moving average cost method and to ensure that all of the items are included in the values reported on the Balance Sheet. Some Department of the Navy commands have not used the consumption method for expensing Operating Materials and Supplies.

Financial Reporting of General Equipment, Real Property, and Military Equipment. Completeness issues may exist with recognizing internal use software and leasehold improvements. The Department of the Navy is working with the Under Secretary of Defense (Acquisition, Technology, and Logistics) and the Department of the Navy major commands to fully implement Statement of Federal Financial Accounting Standards No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment." In addition, the Department of

the Navy is working with the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, to ensure that documentation for real property is available, beginning with FY 1999; an imputed cost policy is properly implemented; and Form DO 1354, "Transfer and Acceptance of Military Property," is properly used throughout the Department of the Navy.

Financial Reporting of Procure to Pay and Disbursements

Accounts Payable. Intragovernmental accounts payable transactions, such as military standard requisitioning and issue procedures, fuel payables, and non-PowerTrack transportation, are not being recorded promptly, completely, or accurately. In addition, some existing Department of the Navy procedures create abnormal balances.

Other Assets. The Department of the Navy acknowledged deficiencies in contract financing progress payments that are included in the other assets line item on the balance sheet.

Statement of Changes in Net Position. Accounts (such as revenue, expenses, gains, losses, and prior-period adjustments, closing to this statement) are not ready for assessment.

Statement of Net Cost. The Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," requires agencies to provide reliable and timely information on the full cost of Federal programs, activities, and outputs. Currently, the Department of the Navy derives from budgetary accounts, and not on an accrual basis, the lntragovernmental Gross Costs and the Gross Costs with the Public, as well as lntragovernmental Earned Revenue and Earned Revenue from the Public.

Internal control work we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies.[*]

[*] A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Attachment
Page **3** of **5**

Report on Compliance with Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for compliance with existing laws and regulations, contracts, and grant agreements related to financial reporting. Management has also acknowledged to us instances of noncompliance and that previously reported instances of noncompliance still exist. Therefore, we did not determine whether the Department of the Navy complied with selected provisions of all applicable laws and regulations, contracts, and grant agreements related to financial reporting. We caution that other noncompliance may have occurred and not been detected. Furthermore, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Because of other scope limitations discussed in this report, we limited our work to determining compliance with selected provisions of the applicable laws and regulations.

Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]) limits the Department of the Navy and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Department of the Navy or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As stated in 31 U.S.C § 1517 (2004), DoD and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act (ADA), the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2013, the Department of the Navy reported one closed ADA violation. Therefore, the Department of the Navy did not comply with 31 U.S.C. §§ 1341(1990).

Compliance With FFMIA Requirements

FFMIA of 1996 requires DoD to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level. The Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Department of the Navy Chief Information Officer, Department of the Navy commands, Department of the Navy activities, and the Defense Finance and Accounting Service are jointly responsible for implementing and maintaining financial management systems that comply substantially with the Federal financial management system requirements in OMB Circular A-127, "Financial Management Systems," applicable U.S. GAAP, and the USSGL at the transaction level. Department of the Navy management states the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to comply substantially with the Federal financial management systems requirements, U.S. GAAP, and the USSGL at the transaction level. The Department of the Navy has based its assessment on system requirements promulgated by OMB in Circular A-127 and by the Office of the Secretary of Defense through the DoD Business Enterprise Architecture laws, regulations, and policies. The Department of the Navy staff recognizes that legacy systems were, in some cases, substantively not compliant and therefore did not perform system reviews for selected legacy systems.

For FY 2013, the Department of the Navy did not fully comply with FFMIA. On December 9, 2013, management stated that Department of the Navy General Fund financial management systems did not substantially comply with the Federal financial management systems requirements as of September 30, 2013. The Department of the Navy previously acknowledged to us that the financial management and feeder systems could not provide adequate evidence supporting various material amounts on the basic statements and that previously identified material weaknesses continued to exist.

Recommendations

This report does not include recommendations to correct the material weaknesses and instances of noncompliance with laws and regulations, because previous audit reports contained recommendations for corrective actions or because audit projects currently in process will include appropriate recommendations.

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

December 9, 2013

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Department of the Navy Working Capital Fund FY 2013 and FY 2012 Basic Financial Statements (Report No. DODIG-2014-013)

Report on the Basic Financial Statements

The Chief Financial Officers Act of 1990, as amended, requires the DoD Inspector General to audit the accompanying Department of the Navy Working Capital Fund Consolidated Balance Sheet as of September 30, 2013 and 2012, and the related Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and notes to the basic financial statements.

Management's Responsibility for the Annual Financial Statements

The annual financial statements are the responsibility of Department of the Navy management. Management is responsible for (1) preparing basic financial statements that conform with generally accepted accounting principles in the United States (U.S. GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that they met broad control objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA); (3) ensuring that the Department of the Navy's financial management systems fully comply with Federal Financial Management Improvement Act of 1996 (FFMIA) requirements; and (4) complying with applicable laws and regulations.

Auditor's Responsibility

Our responsibility is to express an opinion on the basic financial statements based on conducting the audit in accordance with U.S. generally accepted government auditing standards and the Office of Management and Budget (OMB) Bulletin 14-02,

"Audit Requirements for Federal Financial Statements," October 21, 2013. Based on the matters described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Section 1008(d) of the FY 2002 National Defense Authorization Act limits the DoD Inspector General to performing only those audit procedures required by U.S. generally accepted auditing standards that are consistent with the representations made by management. Department of the Navy management asserted to us that the Department of the Navy Working Capital Fund FY 2013 and FY 2012 Basic Financial Statements would not substantially conform to U.S. GAAP and that Department of the Navy financial management and feeder systems could not adequately support material amounts on the basic financial statements as of September 30, 2013. Accordingly, we did not perform all the auditing procedures required by U.S. generally accepted government auditing standards and OMB Bulletin 14-02, to determine whether material amounts on the basic financial statements were presented fairly. We considered the scope limitation in forming our conclusions on the basic financial statements.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we could not obtain sufficient evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Department of the Navy Working Capital Fund FY 2013 and FY 2012 Basic Financial Statements. Thus, the basic financial statements may have undetected misstatements that are both material and pervasive.

Other Information in the Annual Financial Statements

We performed our audit to form an opinion on the basic financial statements as a whole. The Department of the Navy presented the Management's Discussion and Analysis, Required Supplementary Information, and Other Information for additional analysis as part of the basic financial statements; these elements are not required parts of the basic financial statements. Based on our limited review, we did not find any material inconsistencies between the other information and the basic financial statements and applicable sections of OMB Circular No. A-136 (Revised), "Financial Reporting Requirements," October 21, 2013, and

DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6b, "Form and Content of DoD Audited Financial Statements" April 2013. However, we do not express an opinion on the information.

Report on Other Legal and Regulatory Requirements, Contracts, and Grant Agreements

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have a direct and material effect on the basic financial statements and with OMB regulations and audit requirements for financial reporting because management represented that instances of noncompliance identified in prior audits still exist. Therefore, we did not determine whether the Department of the Navy complied with all applicable laws and regulations, contracts, and grant agreements related to financial reporting. Providing an opinion on internal control and compliance with certain provisions of laws and regulations, contracts, and grant agreements was not an objective of our audit, and accordingly, we do not express such an opinion.

See attachment for additional details on internal control and compliance with legal and other regulatory requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to the Department of the Navy. However, management did not provide comments.

This report is intended solely for the information and use of Department of the Navy management, the DoD Office of the Inspector General, OMB, the U.S. Government Accountability Office, and U.S. Congress, and is not intended to be used, and should not be used, by anyone other than these specified parties.

Lorin T. Venable

Lorin T. Venable, CPA
Assistant Inspector General
Financial Management and Reporting

Attachment: As stated

Report on Internal Control Over Financial Reporting

Internal Control Compliance

In planning our work, we considered the Department of the Navy's internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances for the purposes of expressing our opinion on the basic financial statements but not appropriate to the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on internal control over financial reporting.

Management Responsibilities

Management is responsible for implementing and maintaining effective internal control to include providing reasonable assurance that Department of the Navy personnel accumulated, recorded, and reported accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

Auditor's Responsibilities

Our purpose was not to express an opinion on internal control over financial reporting, and we do not do so. However, the following material weaknesses could adversely affect the Department of the Navy's financial operations.

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continued in the following areas. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's basic financial statements will not be prevented, or detected and corrected on a timely basis.

Financial Management Systems. The Department of the Navy's financial management systems and feeder systems do not comply with Federal financial management system requirements, U.S. GAAP, and U.S. Government Standard General Ledger (USSGL).

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Financial Reporting of Collections and Disbursements - Fund Balance With Treasury. System interfaces do not exist between the financial reporting systems, which result in unmatched disbursements and collections.

Financial Reporting of Plan to Perform/Order to Cash. Subsidiary records are not reconciled to corresponding general ledger accounts on a regular basis, resulting in control weaknesses and no audit trail. Also, unmatched collections post to accounts receivable using journal vouchers, leaving no audit trail.

Financial Reporting of Inventory. Supply management activities record inventory at the latest acquisition cost due to inadequate data, processes, and methodologies to make accurate conversions. To comply with U.S. GAAP, the latest acquisition cost must be converted to an approximation of historical cost.

Financial Reporting of Operating Materials and Supplies. Government Furnished Material is generally not included in the Operating Materials and Supplies amounts reported.

Financial Reporting of Real Property and General Equipment. Ownership and valuation of General Equipment cannot be established or supported due to lack of supporting documentation, improper interpretation of guidance, underutilization of the accounting system of record, and system limitations. In addition, asset records do not represent all General Equipment assets, including all ancillary costs to the asset, or assign a correct useful life. Presentation and disclosure of assets are inaccurate because the property accountability system is not reconciled with the financial systems.

Financial Reporting of Procure to Pay Processes

Accounts Payable. The Accounts Payable line item is adversely affected by insufficient or inconsistent reconciliations and supporting documentation; undistributed disbursements; the inability to capture trading partner information; and the lack of direct system interfaces, which causes matching difficulties. Unmatched disbursements are transferred to accounts payable using journal vouchers, leaving no audit trail and often causing abnormal balances.

Other Liabilities. Unsupported and undistributed disbursements remain unresolved.

Statement of Budgetary Resources. Multiple deficiencies exist within the Statement of Budgetary Resources. For example, Defense Finance and Accounting Service Cleveland staff post adjustments to this statement based on proprietary data. In addition, the Department of the Navy stated that beginning balances should be verified, reconciliation processes be established, and performance reviews be completed. Disconnects between budgetary and proprietary data should be identified and corrected.

Intragovernmental Eliminations. Intragovemmental transactions are not fully reconciled with all Federal partners because these transactions are not tracked by customer or provider.

Unsupported Accounting Entries. Financial feeder systems and accounting systems do not provide sufficient detail to identify Federal and non-Federal or supported and unsupported transactions.

Statement of Net Cost. Current processes and systems do not capture and report accumulated costs for major programs based upon performance measures as required by the Government Performance and Results Act. The Department of the Navy is in the process of reviewing the available data and developing a cost reporting methodology.

Reconciliation of Net Cost of Operations to Budget. Budgetary data are not in agreement with proprietary expenses and assets capitalized because of financial system limitations. The difference between budgetary and proprietary data was previously identified as a system deficiency.

Internal control work we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies.*

Report on Compliance with Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for

* A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

compliance with existing laws and regulations, contracts, and grant agreements related to financial reporting. Management has also acknowledged to us instances of noncompliance and that previously reported instances of noncompliance still exist. Therefore, we did not determine whether the Department of the Navy complied with selected provisions of all applicable laws and regulations, contracts, and grant agreements related to financial reporting. We caution that other noncompliance may have occurred and not been detected. Furthermore, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Because of other scope limitations discussed in this report, we limited our work to determining compliance with selected provisions of the applicable laws and regulations.

Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]) limits the Department of the Navy and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Department of the Navy or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As stated in 31 U.S.C § 1517 (2004), DoD and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act (ADA), the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken.

During FY 2013, the Department of the Navy reported one closed ADA violation. Therefore, the Department of the Navy did not comply with 31 U.S.C. §§ 1341(1990).

Compliance With FFMIA Requirements

FFMIA Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level. The Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Department of the Navy Chief Information Officer, Department of the Navy commands, Department of the Navy activities, and the Defense Finance and Accounting Service are jointly responsible

for implementing and maintaining financial management systems that comply substantially with the Federal financial management system requirements in OMB Circular A-127, "Financial Management Systems," applicable U.S. GAAP, and the USSGL at the transaction level. Department of the Navy management states the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to comply substantially with the Federal financial management systems requirements, U.S. GAAP, and the USSGL at the transaction level. The Department of the Navy has based its assessment on system requirements promulgated by OMB in Circular A-127 and by the Office of the Secretary of Defense through the DoD Business Enterprise Architecture laws, regulations, and policies. The Department of the Navy staff recognizes that legacy systems were, in some cases, substantively not compliant and therefore did not perform system reviews for selected legacy systems.

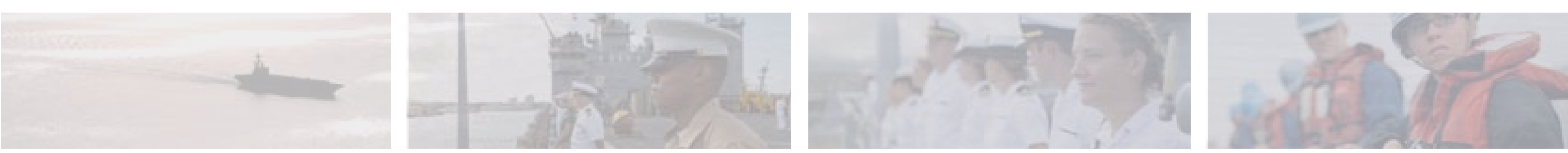
For FY 2013, the Department of the Navy did not fully comply with FFMIA. On December 9, 2013, management stated that Department of the Navy Working Capital Fund financial management systems did not substantially comply with the Federal financial management systems requirements as of September 30, 2013. The Department of the Navy previously acknowledged to us that the financial management and feeder systems could not provide adequate evidence supporting various material amounts on the basic statements and that previously identified material weaknesses continued to exist.

Recommendations

This report does not include recommendations to correct the material weaknesses and instances of noncompliance with laws and regulations, because previous audit reports contained recommendations for corrective actions or because audit projects currently in process will include appropriate recommendations.

Department of the Navy Fiscal Year 2013 Annual Financial Report

Principal Statements



Sailors man the phone and distance line on the forecastle aboard a guided-missile destroyer during an underway replenishment (U.S. Navy photo by Mass Communication Specialist 2nd Class David Hooper/Released)

PRINCIPAL STATEMENTS

The Fiscal Year 2013 Department of the Navy (DON) principal statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the DON for the fiscal year ending September 30, 2013, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2012.

The following statements comprise the DON principal statements:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources

The principal statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the principal statements.

The Independent Auditor's Report refers to the Department of the Navy (DON) financial statements as the Department of the Navy General Fund financial statements.

CONSOLIDATED BALANCE SHEET

As of September 30, 2013 and 2012

($ in Thousands)

		2013 Consolidated		2012 Consolidated
ASSETS				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	142,685,856	$	143,102,685
Investments (Note 4)		8,326		7,968
Accounts Receivable (Note 5)		280,871		195,181
Other Assets (Note 6)		467,313		346,428
Total Intragovernmental		143,442,366		143,652,262
Cash and Other Monetary Assets (Note 7)		98,977		93,840
Accounts Receivable, Net (Note 5)		3,853,141		3,616,372
Inventory and Related Property, Net (Note 8)		75,063,235		68,340,085
General Property, Plant, and Equipment, Net (Note 9)		269,951,986		228,851,453
Other Assets (Note 6)		50,709,475		46,118,969
TOTAL ASSETS	$	543,119,180	$	490,672,981
Stewardship Property, Plant, and Equipment (Note 9)				
LIABILITIES				
Intragovernmental:				
Accounts Payable (Note 11)	$	1,897,903	$	1,587,406
Other Liabilities (Note 13)		4,474,008		4,386,160
Total Intragovernmental Liabilities		6,371,911		5,973,566
Accounts Payable (Note 11)		398,830		232,068
Federal Employee and Veteran Benefits (Note 15)		1,719,183		1,670,760
Environmental and Disposal Liabilities (Note 12)		21,663,602		21,599,934
Other Liabilities (Note 13 & Note 14)		8,614,364		8,172,836
TOTAL LIABILITIES		38,767,890		37,649,164
Commitments and Contingencies (Note 14)				
NET POSITION				
Unexpended Appropriations - Other Funds		187,097,659		184,561,909
Cumulative Results of Operations - Dedicated Collections		27,762		29,532
Cumulative Results of Operations - Other Funds		317,225,869		268,432,376
TOTAL NET POSITION	$	504,351,290	$	453,023,817
TOTAL LIABILITIES AND NET POSITION	$	543,119,180	$	490,672,981

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2013 and 2012

($ in Thousands)

	2013 Consolidated	2012 Consolidated
Program Costs		
Gross Costs		
Military Personnel	$ 45,558,971	$ 47,405,225
Operations, Readiness, & Support	60,652,956	63,204,636
Procurement	32,722,780	50,485,242
Research, Development, Test, & Evaluation	16,070,203	16,764,357
Family Housing & Military Construction	1,650,910	2,434,831
Less: Earned Revenue	(11,022,888)	(10,599,907)
Net Cost of Operations	$ 145,632,932	$ 169,694,384

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Year Ended September 30, 2013

($ in Thousands)

	2013 Dedicated Collections	2013 Other Funds	2013 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 29,532	$ 268,432,376	$ 268,461,908
Budgetary Financing Sources:			
Appropriations Used	-	157,318,575	157,318,575
Nonexchange Revenue	210	-	210
Donations & Forfeitures of Cash & Cash Equivalents	22,822	492	23,314
Transfers-In/Out without Reimbursement	-	10,500	10,500
Other Financing Sources:			
Donations and Forfeitures of Property	-	6,897	6,897
Transfers-In/Out without Reimbursement	-	(654,769)	(654,769)
Imputed Financing from Costs Absorbed by Others	-	746,117	746,117
Other	-	36,973,812	36,973,812
Total Financing Sources	23,032	194,401,624	194,424,656
Net Cost of Operations	24,426	145,608,506	145,632,932
Net Change	(1,394)	48,793,118	48,791,724
Cumulative Results of Operations	28,138	317,225,494	317,253,632
UNEXPENDED APPROPRIATIONS			
Beginning Balances	-	184,561,909	184,561,909
Budgetary Financing Sources:			
Appropriations Received	-	174,139,345	174,139,345
Appropriations Transferred-In/Out	-	(666,067)	(666,067)
Other Adjustments (Rescissions, etc.)	-	(13,618,953)	(13,618,953)
Appropriations Used	-	(157,318,575)	(157,318,575)
Total Budgetary Financing Sources	-	2,535,750	2,535,750
Unexpended Appropriations	-	187,097,659	187,097,659
Net Position	28,138	504,323,153	504,351,291

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Year Ended September 30, 2012

($ in Thousands)

	2012 Dedicated Collections	2012 Other Funds	2012 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 25,545	267,253,020	$ 267,278,565
Budgetary Financing Sources:			
Appropriations Used	(41)	166,059,179	166,059,138
Nonexchange Revenue	218	-	218
Donations & Forfeitures of Cash & Cash Equivalents	23,734	237	23,971
Transfers-In/Out without Reimbursement	-	-	-
Other Financing Sources:			
Donations and Forfeitures of Property	-	1,742	1,742
Transfers-In/Out without Reimbursement	-	(138,094)	(138,094)
Imputed Financing from Costs Absorbed by Others	-	816,514	816,514
Other	-	4,114,238	4,114,238
Total Financing Sources	23,911	170,853,816	170,877,727
Net Cost of Operations	19,924	169,674,460	169,694,384
Net Change	3,987	1,179,356	1,183,343
Cumulative Results of Operations	29,532	268,432,376	268,461,908
UNEXPENDED APPROPRIATIONS			
Beginning Balances	-	178,477,576	178,477,576
Budgetary Financing Sources:			
Appropriations Received	-	173,531,259	173,531,259
Appropriations Transferred-In/Out	-	1,376,886	1,376,886
Other adjustments (Rescissions, etc.)	(41)	(2,764,633)	(2,764,674)
Appropriations Used	41	(166,059,179)	(166,059,138)
Total Budgetary Financing Sources	-	6,084,333	6,084,333
Unexpended Appropriations	-	184,561,909	184,561,909
Net Position	29,532	452,994,285	453,023,817

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2013 and 2012

($ in Thousands)

		2013 Combined		2012 Combined
Budgetary Resources:				
Unobligated Balance, Brought Forward, October 1	$	32,549,715	$	33,205,881
Recoveries of Prior Year Unpaid Obligations		11,866,228		13,249,015
Other Changes in Unobligated Balance		(1,955,989)		(1,337,751)
Unobligated Balance from Prior Year				
Budget Authority, net		42,459,954		45,117,145
Appropriations		161,841,280		173,505,214
Spending Authority from Offsetting Collections		7,367,629		8,105,260
Total Budgetary Resources	$	211,668,863	$	226,727,619
Status of Budgetary Resources:				
Obligations Incurred	$	178,352,738	$	194,177,904
Unobligated Balance, End of Year				
Apportioned		28,231,804		28,451,635
Exempt from Apportionment		20,725		-
Unapportioned		5,063,596		4,098,080
Unobligated Balance Brought Forward, End of Year		33,316,125		32,549,715
Total Budgetary Resources	$	211,668,863	$	226,727,619
Change in Obligated Balance:				
Unpaid Obligations				
Unpaid Obligations, Brought Forward, October 1	$	112,927,456	$	107,478,038
Obligations Incurred		178,352,738		194,177,904
Outlays, gross		(166,935,123)		(175,479,471)
Recoveries of Prior Year Unpaid Obligations		(11,866,228)		(13,249,015)
Unpaid Obligations, End of Year, gross		112,478,843		112,927,456
Uncollected payments				
Uncollected Payments from Federal Sources, Brought Forward, October 1		(2,629,802)		(2,509,887)
Change in Uncollected Customer Payments from Federal Sources		(599,692)		(119,916)
Uncollected Payments from Federal Sources, End of Year		(3,229,494)		(2,629,803)
Obligated Balance, Start of Year	$	110,297,654	$	104,968,151
Obligated Balance, End of Year	$	109,249,349	$	110,297,653
Budget Authority and Outlays, Net:				
Budget Authority, gross	$	169,208,909	$	181,610,474
Actual Offsetting Collections		(6,767,937)		(7,985,345)
Change in Uncollected Customer Payments from Federal Sources		(599,692)		(119,916)
Budget Authority, net	$	161,841,280	$	173,505,213
Outlays, gross	$	166,935,123	$	175,479,471
Actual Offsetting Collections		(6,767,937)		(7,985,345)
Outlays, net		160,167,186		167,494,126
Distributed Offsetting Receipts		(86,119)		(226,131)
Agency Outlays, Net	$	160,081,067	$	167,267,995

The accompanying notes are an integral part of the statements.

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the DON in accordance with, and to the extent possible, U .S. Generally Accepted Accounting Principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB); the Office of Management and Budget (OMB) Circular No. A-136, Financial Reporting Requirements; and the Department of Defense (DoD), Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the DON is responsible unless otherwise noted.

Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernible.

The DON financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance and Accounting Service, Cleveland (DFAS-CL) collects information from the financial system and incorporates it into the financial statements for the DON. The DON collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL for incorporation into the financial statements. On behalf of the DON, DFAS-CL also collects information from multiple sources, such as intragovernmental data from the DON's trading partners, which is incorporated into the financial statements. The Defense Departmental Reporting System Data Collection Module (DDRS DCM) captures certain required financial information from non-integrated systems for the DON financial statements. The DDRS DCM identifies the information requirements to the source provider, and integrates data into the financial statement preparation process.

The DON is unable to fully implement all elements of USGAAP and the OMB Circular No. A-136 due to limitations of its financial and nonfinancial management processes and systems that support the financial statements. The DON derives reported values and information for major asset and liability categories largely from nonfinancial systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with USGAAP. The DON continues to implement process and system improvements addressing these limitations. The DON is currently converting legacy systems to Navy Enterprise Resource Planning (ERP) and developing plans to ensure accurate and complete financial records.

The Department of Defense Inspector General (DoDIG) issued an audit report identifying 11 financial statement material weaknesses: (1) Financial Management Systems; (2) Fund Balance With Treasury; (3) Problem Disbursements; (4) Unobligated Balances; (5) Financial Reporting of Plan to Perform/Order to Cash; (6) Financial Reporting of Operating Materials and Supplies; (7) Financial Reporting of General Equipment, Real Property, and Military Equipment; (8) Accounts Payable; (9) Other Assets; (10) Statement of Changes in Net Position; (11) Statement of Net Cost.

The FY 2012 financial statements were reclassified to conform to the FY 2013 financial statement presentation requirements. Changes to the presentation of the Combined and Combining Statements of Budgetary Resources were made, in accordance with guidance provided in OMB Circular No. A-136, Financial Reporting Requirements, and as such, activity and balances reported on the FY 2012 Combined and Combining Statement of Budgetary Resources have been reclassified to conform to the presentation in the current year. Certain other prior year amounts have also been reclassified to conform to the current year presentation. The reclassifications had no material effect on total assets, liabilities, net position, change in net position, or budgetary resources as previously reported.

Subsequent events and transactions occurring after September 30, 2013 through the date of the auditors' opinion should be evaluated for potential recognition or disclosure in the financial statements. However, the DON is not yet able to implement this requirement. The date of the auditors' opinion also represents the date that the financial statements were available to be issued.

1.B. Mission of the Reporting Entity

The DON was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U .S .C . 411-12) . The overall mission of the DON is to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression, and maintaining freedom of the seas.

1.C. Appropriations and Funds

The DON receives appropriations and funds as general, working capital (revolving), trust, special, and deposit funds. The DON uses these appropriations and funds (excluding deposit funds) to execute its missions and subsequently report on resource usage.

General funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and family housing and military construction.

These general funds also include supplemental funds enacted by the American Recovery and Reinvestment Act (Recovery Act) of 2009.

The National Defense Sealift Fund is the DON's only revolving fund. Revolving funds are generally established for carrying out specific activities. Revolving funds are financed through an appropriation or a transfer to establish a corpus and are replenished through charges made for goods or services without fiscal year limitations. The National Defense Sealift Fund receives an annual appropriation and has no corpus.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as funds from dedicated collections. Funds from dedicated collections are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The DON is required to separately account for and report on the receipt, use and retention of revenues and other financing sources for funds from dedicated collections.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. They are not the DON funds, and as such, are not available for the DON's operations. The DON is acting as an agent or a custodian for funds awaiting distribution.

The DON is a party to allocation transfers with other federal agencies as a transferring (parent) entity or receiving (child) entity. An allocation transfer is an entity's legal delegation of authority to obligate budget authority and outlay funds on its behalf. Generally, all financial activity related to allocation transfers (e.g. budget authority, obligations, outlays) is reported in the financial statements of the parent entity. Exceptions to this general rule apply to specific funds for which OMB has directed that all activity be reported in the financial statements of the child entity. These exceptions include U.S. Treasury-Managed Trust Funds, Executive Office of the President (EOP), and all other funds specifically designated by OMB.

Additionally, the DON receives allocation transfers from the EOP for the Foreign Military Financing Program (meeting the OMB exception), the International Military Education and Training Program, U.S. Forest Service, and the Federal Highway Administration. The activities for these funds are reported separately from the DoD financial statements and reported to the parent.

The DON receives allocation transfers for the Security Assistance programs that meet the OMB exception for EOP funds. These funds are reported separately from the DoD financial statements based on an agreement with OMB.

1.D. Basis of Accounting

The DON's financial management systems are unable to meet all full accrual accounting requirements. Many of the DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by USGAAP. Most of the DON's financial and nonfinancial legacy systems were designed to record information on a budgetary basis.

Although the DON has not fully implemented accrual accounting, under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Under the budgetary basis, however, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

The DON financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the DON's sub-entities. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, environmental liabilities, and Federal Employees' Compensation Act (FECA) liabilities. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated DON level these abnormal balances may not be evident. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

The DoD is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the conversion of the DON's legacy systems to ERP which is designed to modernize and standardize Navy's business practices. Navy ERP was developed utilizing the USSGL account structure to better comply with applicable financial management requirements. Until all the DON financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by USGAAP, financial data will be derived from proprietary transactions, data from nonfinancial feeder systems, and accruals.

The preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amount of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

1.E. Revenues and Other Financing Sources

The DON receives congressional appropriations as financing sources for the DON that expire annually, on a multi-year basis, or do not expire. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The DON recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full-cost pricing is the DON's standard policy for services provided as required by OMB Circular A-25, User Charges. The DON recognizes revenue when earned within the constraints of its current system capabilities.

The DON does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost. The U.S. has cost sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items such as payroll expenses, accounts payable, environmental liabilities, and FECA liabilities. In the case of Operating Materials & Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses. Under the consumption method, OM&S would be expensed when consumed. Due to system limitations, in some instances expenditures for capital and other long-term assets may be recognized as operating expenses. The DON continues to implement process and system improvements to address these limitations.

1.G. Accounting for Intragovernmental Activities

Accounting standards require that an entity eliminates intra-entity activity and balances from consolidated financial statements in order to prevent overstatement for business with itself. However, the DON cannot accurately identify intragovernmental transactions by customer because the DON's systems do not track buyer and seller data at the transaction level. Generally, seller entities within the DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances and are then eliminated. The DoD is implementing replacement systems and a standard financial information structure that will incorporate the necessary elements that will enable DoD to correctly report, reconcile, and eliminate intragovernmental balances.

Treasury Financial Manual Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" provides guidance for reporting and reconciling intragovernmental balances. While the DON is unable to fully reconcile intragovernmental transactions with all federal agencies, the DON is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing

Bank, FECA transactions with the U.S. Department of Labor, and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements do not report any public debt, interest, or source of public financing, whether from issuance of debt or tax revenues.

Generally, financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the U.S. Treasury does not allocate such costs to DoD.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the DON sells defense articles and services to foreign governments and international organizations under the provisions of the Arms Export Control Act of 1976. Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the Federal Government. Payment in U.S. dollars is required in advance.

1.I. Funds with the U.S. Treasury

The DON's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the DON's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis DFAS performs a reconciliation between the DON's FBWT and the U.S. Treasury.

1.J. Cash and Other Monetary Assets

Cash is the total of cash resources under the control of DoD which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

The majority of cash and all foreign currency is classified as "nonentity" and is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

The DON conducts a significant portion of operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions for five DON appropriations: (1) operations and maintenance; (2) military personnel; (3) military construction; (4) family housing operation and maintenance; and (5) family housing construction. The gains and losses are calculated as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The DON does not separately identify currency fluctuation transactions.

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. In accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities, the methodology for losses due to uncollectable amounts are based on an individual account analysis and/or group analysis. The analysis is based on three years of receivable data. This data is used to determine the historical percentage of collections in each age category of receivables. The DON does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute

resolution procedures defined in the Treasury Financial Manual Part 2, Chapter 4700, Appendix 10, "Intragovernmental Business Rules".

1.L. Inventories and Related Property

The DON manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, support equipment, etc. As it relates to the DON, OM&S includes the related spares and repair parts for materiel. Items commonly used in and available from the commercial sector are not managed in the DON's materiel management activities. The DON holds materiel based on military need and support for contingencies.

The DON uses both the consumption method and the purchase method of accounting for OM&S. The DON OM&S is categorized as operating materials and supplies held for use, operating materials and supplies held in reserve for future use (held for repair) (including munitions not held for sale) and excess, obsolete and unserviceable operating material and supplies. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the DON uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2013 and 2012, the DON expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

The DON OM&S assets held for use and held for repair use three cost valuation methods: Standard Price (SP), Latest Acquisition Cost (LAC), and Moving Average Cost (MAC). Excess, obsolete, and unserviceable OM&S are cost valued using Net Realizable Value pending development of an effective means of valuing such material. The LAC method is used because legacy logistics systems were designed for material management rather than accounting purposes. Although these systems provide visibility and accountability over inventory and related property items, they do not maintain historical cost data necessary to comply with SFFAS No. 3. Additionally, these legacy inventory systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (FFMIA). The DON is continuing to transition OM&S to the MAC method. Most transitioned balances, however, were not baselined to auditable historical cost, and remain noncompliant with SFFAS No. 3.

The DON determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high dollar items, such as aircraft engines, are categorized as OM&S rather than military equipment.

1.M. Investments in U.S. Treasury Securities

The DON reports investments in accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities. The DON reports U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments using the effective interest rate method or another method obtaining similar results. The DON's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The DON invests in nonmarketable market-based U.S. Treasury securities, which are issued to federal agencies by the U.S. Treasury's Bureau of Public Debt. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

1.N. General Property, Plant and Equipment

General Property, Plant and Equipment (PP&E) assets are capitalized in accordance with SFFAS No. 6, Accounting for Property, Plant and Equipment, as amended by SFFAS Nos. 10, 23, and 35, when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD's capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DON depreciates all General PP&E, other than land and Military Equipment (ME) classified as aircraft, on a straight-line basis in accordance with FMR Volume 4 Chapter 6. The DoD's General PP&E capitalization threshold is $100 thousand except for real property, which is $20 thousand.

The DON uses a combination of actual expenditure data and program funding to calculate the value for ME in accordance with SFFAS No. 35. The DON is developing a process to track and record actual ME costs. The ME value is updated using expenditure, acquisition, and disposal information.

When it is in the best interest of the government, the DON provides government property to contractors to complete contract work. The DON either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E meets or exceeds the DoD capitalization threshold, federal accounting standards require that it be reported on the DON's Balance Sheet.

The DoD developed policy and a reporting process for contractors with government furnished equipment that provides appropriate General PP&E information for financial statement reporting in accordance with Federal Acquisition Regulations (FAR). The DoD requires the DON to maintain, in their property systems, information on all property furnished to contractors. These actions are structured to capture and report the information necessary for compliance with federal accounting standards. The DON has not fully implemented this policy primarily due to system limitations.

1.O. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy as prescribed in SFFAS No. 1, Accounting for Selected Assets and Liabilities is to record advances or prepayments in accordance with USGAAP. As such, payments made prior to the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The DON has not implemented this policy primarily due to system limitations.

Due to inconsistencies in the posting logic for Nonfederal Advances and Prepayments, the DON is noncompliant with the FFMIA, which requires agencies to comply with the Federal financial management systems requirements, standards promulgated by the FASAB, and the USSGL at the transaction level.

1.P. Leases

In accordance with SFFAS No. 5, Accounting for Liabilities of the Federal Government, lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, the DON records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The DON records the asset and the liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The DON, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are expensed over the lease term as they become payable.

Office space leases entered into by the DON are the largest component of operating leases and are based on costs gathered from existing leases, General Services Administration bills, and interservice support agreements. Future year projections use the Consumer Price Index.

1.Q. Other Assets

Other assets include those assets, such as military and civil service employee pay advances and certain contract financing payments that are not reported elsewhere on the DON's Balance Sheet. The DON maintains this classification in accordance with SFFAS No. 1.

Advances are cash outlays made by the DON to its employees, contractors, or others to cover a part or all of the recipients' anticipated expenses. Military pay advances are advance payments authorized for purposes intended to ease hardships imposed by the lack of regular payments when a military member is mobilized, ordered to duty at distant stations, or deployed aboard ships for more than 30 days. Civilian pay advances are payments advanced to full time the DON civilians intended to finance unusual employee expenses associated with oversea assignments that are not otherwise reimbursed and to aid foreign assignment recruitment and retention. Travel advances are disbursed to employees prior to business trips. Travel advances are subsequently reduced when travel expenses are actually incurred.

The DON conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the DON may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulation, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. It is DoD policy to record certain contract financing payments as other assets. The DON has not fully implemented this policy primarily due to system limitations.

1.R. Contingencies and Other Liabilities

The DON is party to various administrative proceedings, legal actions, and claims. Under SFFAS No. 5, Accounting for Liabilities of the Federal Government, as amended by SFFAS No. 12, Recognition of Contingent Liabilities Arising from Litigation, the Balance Sheet should include estimated liabilities for these items when an adverse decision is probable, reasonably possible, and estimable. When the amount of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is remote, the contingency is not disclosed.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The DON's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship, and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities also arise as a result of anticipated disposal costs for the DON's assets. Consistent with SFFAS No. 6, Accounting for Property, Plant and Equipment, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. The DON adheres to the DoD's policy, which is consistent with SFFAS No. 5, Accounting for Liabilities of Federal Government, and states that nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. The DoD recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

1.S. Accrued Leave

Military leave, compensatory and annual leave earned by civilians, but not yet used, is reported as accrued liabilities. The accrued balance is adjusted annually to reflect current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.T. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.U. Treaties for Use of Foreign Bases

The DoD has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The DON purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. Treaty terms generally allow the DON continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, use of the foreign bases is prohibited and losses are recorded for the value of any nonretrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

1.V. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S.

Treasury. Supported disbursements and collections may be evidenced by the availability of corroborating documentation that would generally support the summary-level adjustments made to accounts payable and receivable. Both supported and unsupported adjustments may have been made to the DON's Accounts Payable and Receivable trial balances prior to validating that the underlying transactions required to establish the Accounts Payable/Receivable were previously made. As a result, misstatements of reported Accounts Payable and Receivables are likely present in the DON's financial statements.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD is generally unable to determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, the DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Both supported and unsupported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly.

1.W. Fiduciary Activities

Fiduciary cash and other assets are not assets of the DON and are not recognized on the balance sheet. Fiduciary activities are reported on the financial statement note schedules in accordance with SFFAS No. 31, Accounting for Fiduciary Activities.

1.X. Federal Employee and Veteran Benefits

For financial reporting purposes, the DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON at the end of each fiscal year. Military retirement is accounted for in the audited financial statements of the Military Retirement fund; as such, the DON does not record any liabilities or obligations for pensions or healthcare retirement benefits.

NOTE 2. NONENTITY ASSETS

As of September 30

(Amounts in thousands)

	2013	2012
Intragovernmental		
Fund Balance with Treasury	$ 198,608	$ 288,275
Cash and Other Monetary Assets	98,977	93,840
Accounts Receivable	3,710,658	3,528,238
Total Nonentity Assets	4,008,243	3,910,353
Total Entity Assets	539,110,937	486,762,628
Total Assets	$ 543,119,180	$ 490,672,981

Nonentity assets are assets for which the DON maintains stewardship accountability and reporting responsibility but which are not available for the DON's normal operations.

Intragovernmental Fund Balance with Treasury
This nonentity asset category primarily represents amounts in the DON's Suspense Funds, Withheld State and Local Taxes Fund, and Withheld Allotment of Compensation for Payment of Employee Organization Dues Fund.

Cash and Other Monetary Assets
This nonentity asset category represents disbursing officers' cash, foreign currency, and undeposited collections as reported on the Disbursing Officer's Statement of Accountability. These assets are held by the DON disbursing officers on behalf of other agencies and are not available for the DON's use in normal operations.

Nonentity Nonfederal Accounts Receivable (Public)

The primary component of nonentity accounts receivable is an advance payment made to a contractor for the A-12 aircraft procurement program, which remains in litigation and includes associated accrued interest. These receivable balances are being reported in nonentity accounts receivable since the original appropriation year has been cancelled, and any funds collected as a result of this litigation would be remitted to the U.S. Treasury.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30

(Amounts in thousands)

	2013	2012
Fund Balances		
Appropriated Funds	$ 141,795,951	$ 141,644,490
Revolving Funds	667,591	1,147,198
Trust Funds	21,535	20,588
Special Funds	2,171	2,134
Other Fund Types	198,608	288,275
Total	$ 142,685,856	$ 143,102,685

Other Fund Types consists primarily of amounts in the following deposit and receipt accounts: The DON Proprietary Receipts, Pay of the Navy Deposit Fund, and Pay of the Marine Corps Deposit Fund.

Status of Fund Balance with Treasury

As of September 30

(Amounts in thousands)

	2013	2012
Unobligated Balance		
Available	$ 28,252,529	$ 28,451,635
Unavailable	5,066,166	4,098,080
Obligated Balance not yet Disbursed	112,478,843	112,927,456
Non-Budgetary FBWT	126,117	263,260
Non-FBWT Budgetary Accounts	(3,237,799)	(2,637,746)
Total	$ 142,685,856	$ 143,102,685

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable balance consists primarily of funds invested in U.S. Treasury securities that are temporarily precluded from obligation by law. Certain unobligated balances are restricted for future use and are not apportioned for current use. Unobligated balances for trust fund accounts are restricted for use by the public law that established the funds.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods and services not received, and those received but not paid.

Non-budgetary FBWT includes accounts that do not have budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts and nonentity FBWT. For the DON, Non-budgetary FBWT consists of balances in receipt accounts and clearing accounts. Due to the DON systems inability to segregate Budgetary FBWT balances, Non-FBWT Budgetary Accounts are used to reconcile the Status of FBWT.

Other

As of September 30 (Amounts in thousands)	2013	2012
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	$ 144,200,615	$ 144,586,439
Fund Balance per the DON	142,685,856	143,102,685
Reconciling Amount	$ 1,514,759	$ 1,483,754

NOTE 4. INVESTMENTS AND RELATED INTEREST

As of September 30

(Amounts in thousands)

2013	Cost	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	$ 8,332	$ (15)	$ 8,317	$ 8,318
Accrued Interest	8	-	8	8
Total	$ 8,340	$ (15)	$ 8,325	$ 8,326

As of September 30

(Amounts in thousands)

2012	Cost	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	$ 7,985	$ (28)	$ 7,957	$ 7,957
Accrued Interest	11	-	11	11
Total	$ 7,996	$ (28)	$ 7,968	$ 7,968

Other Funds represents the DON Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the DON General Gift Fund. These investments are Nonmarketable Market-Based U.S. Treasury securities reported at cost, net of amortized premiums and discounts. In accordance with the SFFAS No. 27, Identifying and Reporting Funds from Dedicated Collections, the DON Trust Funds are reported as funds from dedicated collections.

NOTE 5. ACCOUNTS RECEIVABLE

As of September 30

(Amounts in thousands)

2013	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 280,871	$ N/A	$ 280,871
Nonfederal Receivables (From the Public)	3,873,235	(20,094)	3,853,141
Total	$ 4,154,106	$ (20,094)	$ 4,134,012

As of September 30			
(Amounts in thousands)			
	2012		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 195,181	$ N/A	$ 195,181
Nonfederal Receivables (From the Public)	3,636,386	(20,014)	3,616,372
Total	$ 3,831,567	$ (20,014)	$ 3,811,553

The accounts receivable represent the DON's claim for payment from other entities. Intra-governmental Receivables primarily represents amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules. Refer to Note 2, Nonentity Assets for additional information on non-Federal Accounts Receivable. Since the DON is at risk of not collecting on these public accounts receivable, the DON is recognizing an allowance for uncollectible amounts. The methodology used in determining the allowance amount is discussed in Note 1.K.

The DON is currently working on an effort to drive compliance with Office of Management and Budget (OMB) Circular A-11, Section 20.4(b)(4). Non-compliance results in unsupported departmental level adjustments which negatively impacts achievement of the DON's audit readiness goals for its Statement of Budgetary Resources. The DON is partnering with the DFAS to clarify guidance, resolve funding issues and standardize business practices. In addition, the DON and DFAS are aggressively pursuing collection mechanisms for amounts currently due from the public.

NOTE 6. OTHER ASSETS

As of September 30		
(Amounts in thousands)		
	2013	2012
Intragovernmental Other Assets		
Advances and Prepayments	$ 467,313	$ 346,428
Outstanding Contract Financing Payments	50,425,911	45,824,661
Advances and Prepayments	269,634	282,061
Other Assets (With the Public)	13,930	12,247
Total Nonfederal Other Assets	50,709,475	46,118,969
Total	$ 51,176,788	$ 46,465,397

Intra-governmental Other Assets - Advances and Prepayments
Advances are cash outlays made by a federal entity to cover a part or all of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity receives. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.

Nonfederal Other Assets - Outstanding Contract Financing Payments (OCFP)
Contract terms and conditions for certain types of contract financing payments conveying certain rights to the Government that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DON is not obligated to make payment to the contractor until delivery and acceptance. Some of the amounts reported as OCFP may be progress payments based on percentage or stage of completion. However, the DON is unable to identify these due to system limitations and all amounts are reported as OCFP.

The balance of OCFP includes $49.1 billion in contract financing payments and an additional $1.3 billion in estimated future payments to contractors upon delivery and government acceptance of a satisfactory product. (See additional discussion in Note 13, Other Liabilities).

Nonfederal Other Assets - Other Assets (With the Public)
Other Assets (With the Public) includes advance pay to the DON military personnel, travel advances to military and civilian personnel, and miscellaneous advances to contractors that are not considered outstanding contract financing payments.

NOTE 7. CASH AND OTHER MONETARY ASSETS

As of September 30 (Amounts in thousands)	2013	2012
Cash	$ 71,703	$ 65,511
Foreign Currency	27,274	28,329
Total	$ 98,977	$ 93,840

Cash and Foreign Currency consist primarily of cash held by the DON Disbursing Officers to carry out their payment, collection, and foreign currency accommodation exchange mission. Foreign Currency is also held in overseas banks in support of contingency operations. The primary source of the amounts reported is the Disbursing Officers Statements of Accountability.

Total Cash, Foreign Currency, and Other monetary assets reported are nonentity assets that are not available for the DON's use in normal operations. Therefore, the entire Cash and Foreign Currency balance is restricted as to its use.

NOTE 8. INVENTORY AND RELATED PROPERTY

As of September 30 (Amounts in thousands)	2013	2012
Inventory, Net	$ 46	$ -
Operating Materials & Supplies, Net	75,063,189	68,340,085
Total	$ 75,063,235	$ 68,340,085

Operating Materials and Supplies, Net

As of September 30 (Amounts in thousands) 2013	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use	$ 67,741,862	$ (8,704)	$ 67,733,158	SP, LAC, MAC
Held for Repair	7,341,940	(11,909)	7,330,031	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,467,965	(1,467,965)	-	NRV
Total	$ 76,551,767	$ (1,488,578)	$ 75,063,189	

As of September 30

(Amounts in thousands)

	2012			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use	$ 64,466,653	$ (28,046)	$ 64,438,607	SP, LAC, MAC
Held for Repair	4,700,125	(798,647)	3,901,478	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,249,665	(1,249,665)	-	NRV
Total	$ 70,416,443	$ (2,076,358)	$ 68,340,085	

Legend for Valuation Methods:

LAC = Latest Acquisition Cost NRV = Net Realizable Value

SP = Standard Price MAC = Moving Average Cost

The DON assigns Operating Materials & Supplies (OM&S) items to a category based upon the type and condition of the asset. OM&S Held for Use includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. The DON is currently using the allowance method of accounting for repairables in the legacy accounting system and the direct method of accounting for repairables in Navy Enterprise Resource Planning (ERP). Excess, Obsolete, and Unserviceable OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal.

The consumption method shall be applied when accounting for OM&S and valued at moving average cost using historical cost or any method approximating historical cost (e.g., standard cost or latest acquisition cost). Exceptions to the consumption method are provided when (1) the OM&S are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost beneficial to apply the consumption method. In any of these events, the purchase method is allowed. Legacy accounting systems cannot support the consumption method of accounting, thus the various reporting activities are currently using the purchase method. As financial reporting entities begin to purchase material in Navy ERP, the consumption method will be properly applied.

OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The Moving Average Cost valuation method is used for a majority of the OM&S categories; however Actual Cost and Latest Acquisition Cost are also valuation methods applied depending on the legacy inventory system used to forecast OM&S cost.

Ammunition and Munitions are maintained in the DON Ordnance Information System and valued at latest acquisition cost.

Principal End and Secondary Items include OM&S such as shipboard hull, mechanical and electronic equipment, and uninstalled aircraft engines. They are items of such importance that central inventory control is required to provide the readiness of the material for the Fleet. These items possess one of the following characteristics: essential for combat or training; high dollar value; difficult to procure or produce; or critical basic material or component parts. Principal End and Secondary Items are valued at Moving Average Cost.

Other OM&S consists primarily of Fleet Hospitals held by the Bureau of Medicine and Surgery and War Reserve material in possession of the U.S. Coast Guard.

NOTE 9. GENERAL PP&E, NET

As of September 30

(Amounts in thousands)

2013	Depreciation/ Amortization Method	Service Life	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 659,876	$ N/A	$ 659,876
Buildings, Structures, and Facilities	S/L	20 or 40	46,837,512	(25,252,572)	21,584,940
Leasehold Improvements	S/L	lease term	6,530	(3,014)	3,516
Software	S/L	2-5 or 10	5,763	(2,166)	3,597
General Equipment	S/L	5 or 10	17,540,068	(9,981,526)	7,558,542
Military Equipment	S/L	Various	430,595,909	(201,884,661)	228,711,248
Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	10,410,579	N/A	10,410,579
Other			1,019,688	-	1,019,688
Total General PP&E			$ 507,075,925	$ (237,123,939)	$ 269,951,986

As of September 30

(Amounts in thousands)

2012	Depreciation/ Amortization Method	Service Life	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 612,657	$ N/A	$ 612,657
Buildings, Structures, and Facilities	S/L	20 or 40	43,733,681	(23,834,274)	19,899,407
Leasehold Improvements	S/L	lease term	6,530	(2,702)	3,828
Software	S/L	2-5 or 10	3,405	(3,008)	397
General Equipment	S/L	5 or 10	14,858,936	(8,900,915)	5,958,021
Military Equipment	S/L	Various	416,154,006	(222,121,894)	194,032,112
Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	7,189,011	N/A	7,189,011
Other			1,156,020	-	1,156,020
Total General PP&E			$ 483,714,246	$ (254,862,793)	$ 228,851,453

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable

The DON has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the DON continued use of these properties until the treaties expire. There are no other known restrictions on General PP&E.

The DON estimates values for capitalized Military Equipment using department internal records such as budgetary information for aircraft and expenditure data for ships. Currently, the DON is not reporting the construction of Military Equipment in the appropriate Construction-in-Progress account. The DON is reporting the value of the construction of its Military Equipment as an Advance. The DON is currently in the process of readying the Navy ERP system to allow for the proper recording of the construction of its assets.

Other General PP&E consists of Real Property held in Caretaker Status. Caretaker is defined as those properties that Navy still owns, but which are being held awaiting further disposal action to another entity, such as Defense Base Closure and Realignment Commission (BRAC) property awaiting sale or transfer to another Federal agency. As of September 30, 2013, the accumulated depreciation related to these assets in Caretaker status are currently included in the total accumulated depreciation of Buildings Structures and Facilities still in service and is unknown at this time. The DON is researching the dollar value of depreciation expenses related to these assets.

Heritage Assets

Categories	Measure Quantity	As of September 30, 2012	Additions	Deletions	As of September 30, 2013
Buildings and Structures	Each	10,035	-	-	10,035
Archaeological Sites	Each	18,534	4,526	-	23,060
Museum Collection Items (Objects, Not Including Fine Art)	Each	503,938	10,764	12	514,690
Museum Collection Items (Objects, Fine Art)	Each	40,813	105		40,918

Stewardship Land

(Acres in thousands)

Facility Code	Facility Title	As of September 30, 2012	Additions	Deletions	As of September 30, 2013
9110	Government Owned Land	4	-	1	3
9120	Withdrawn Public Land	2,030	-	-	2,030
9130	Licensed and Permitted Land	21	5	-	26
				Grand Total	2,059
				TOTAL - All Other Lands	25
				TOTAL - Stewardship Lands	2,034

Heritage Assets and Stewardship Land

The Federal Accounting Standards Advisory Board's SFFAS No. 29, "Heritage Assets and Stewardship Land," requires note disclosures for these types of assets. The DON's policy is to preserve its heritage assets, which are items of historical, cultural, educational, or artistic importance.

Heritage assets within the DON consist of buildings and structures, archeological sites, and museum collections. The DON defines these as follows:

Buildings and Structures. Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets.

Archeological Sites. Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Historical Places in accordance with Section 110 National Historical Preservation Act.

Museum Collection Items. Items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics.

The DON's stewardship land consists mainly of mission essential land acquired by donation or devise. The DON held the above acres of land as of September 30, 2013.

The Marine Corps continues to make updates to their beginning balances as a result of audit findings.

The overall mission of the DON is to control and maintain freedom of the seas, project power beyond the sea, and influence events and advance U.S. interests across the full spectrum of military operations. As this mission has been executed, the DON has become a large-scale owner of historic buildings, structures, districts, archeological sites and artifacts, ships, aircraft, other cultural resources, and several hundred installations to include stewardship land. Protection of these components of the nation's heritage assets and stewardship land is an essential part of the DON's mission; the DON is committed to responsible cultural resources stewardship.

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30

(Amounts in thousands)

	2013	2012
Intragovernmental Other Liabilities	$ 476,783	$ 519,939
Accounts Payable	$ 4,725	$ 20,837
Federal Employee and Veteran Benefits	1,718,646	1,670,271
Environmental and Disposal Liabilities	21,663,602	21,599,934
Other Liabilities	4,501,869	4,924,700
Total Liabilities Not Covered by Budgetary Resources	$ 28,365,625	$ 28,735,681
Total Liabilities Covered by Budgetary Resources	$ 10,402,265	$ 8,913,483
Total Liabilities	$ 38,767,890	$ 37,649,164

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through Congressional appropriations or earnings of the entity.

Intragovernmental Other Liabilities consists primarily of unfunded Federal Employees' Compensation Act (FECA) liabilities due to the Department of Labor and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

Nonfederal Liabilities

Accounts payable not covered by budgetary resources is related to cancelled year accounts payable that are not budgeted. Federal Employee and Veteran Benefits consist of unfunded FECA actuarial liabilities not due during the current fiscal year. Environmental liabilities are estimates related to future events, and consist of liabilities related to active installations, Defense Base Closure and Realignment Commission sites, equipment and weapons programs, and chemical weapons disposal. Finally, Other Liabilities include annual leave, estimated legal contingent liabilities, and the disposal of excess structures that are not currently budgeted for but will become funded as future events occur.

See Note 12, Environmental and Disposal Liabilities for additional details.

NOTE 11. ACCOUNTS PAYABLE

As of September 30

(Amounts in thousands)

2013	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 1,897,903	$ N/A	$ 1,897,903
Nonfederal Payables (to the Public)	398,830	-	398,830
Total	$ 2,296,733	$ -	$ 2,296,733

As of September 30

(Amounts in thousands)

2012	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 1,587,406	$ N/A	$ 1,587,406
Nonfederal Payables (to the Public)	231,951	117	232,068
Total	$ 1,819,357	$ 117	$ 1,819,474

Accounts Payable includes amounts owed to federal and nonfederal entities for goods and services received by the DON. The DON's systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side accounts payable are adjusted to agree with interagency seller-side accounts receivable. This is accomplished by 1) reclassifying amounts between federal and nonfederal cost categories, 2) accruing additional accounts payable and expenses, and 3) applying both supported and unsupported undistributed disbursements at the reporting entity level.

NOTE 12. ENVIRONMENTAL AND DISPOSAL LIABILITIES

As of September 30

(Amounts in thousands)

	2013	2012
Environmental Liabilities--Nonfederal		
Accrued Environmental Restoration Liabilities		
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 2,609,056	$ 2,511,374
Active Installations—Military Munitions Response Program (MMRP)	2,041,359	1,979,961
Other Accrued Environmental Liabilities—Non-BRAC		
Environmental Corrective Action	$ 56,959	$ 65,352
Environmental Closure Requirements	378,647	374,704
Environmental Response at Operational Ranges	13,305	14,168
Asbestos	308,480	337,428
Non-Military Equipment	541,000	519,390
Other	764	810
Base Realignment and Closure Installations		
Installation Restoration Program	$ 1,362,309	$ 1,417,953
Military Munitions Response Program	114,019	153,939
Environmental Corrective Action / Closure Requirements	13,894	22,879
Environmental Disposal for Military Equipment / Weapons Programs		
Nuclear Powered Military Equipment / Spent Nuclear Fuel	$ 14,076,334	$ 14,055,948
Other Weapons Systems	147,476	146,028
Total	$ 21,663,602	$ 21,599,934

The above table excludes estimated total cleanup costs associated with General Property, Plant, and Equipment of $2.8 billion for FY 2013 and $2.8 billion for FY 2012.

The "Other" type of environmental liabilities under Other Accrued Environmental Costs represents an environmental estimate for disposal of Polychlorinated Biphenyls (PCB) transformers located at various Naval installations.

In addition to the liabilities reported above, the DON has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The DON is unable to provide a reasonable estimate at this time because the extent of restoration required is not known.

Applicable Laws and Regulations for Cleanup Requirements

The following is a list of significant laws that affect the DON's conduct of environmental policy and regulations:

- Superfund Amendments and Reauthorization Act of 1986
- The Resource Conservation and Recovery Act of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984
- The Clean Water Act of 1977, amended the Federal Water Pollution Control Act
- The Safe Drinking Water Act of 1974
- The Clean Air Act, as amended in 1990
- The Atomic Energy Act of 1954

- The Nuclear Waste Policy Act of 1982
- The Low Level Radioactive Waste Policy Amendments Act of 1986
- The National Environmental Policy Act of 1969 (only Defense Base Closure and RealignmentCommission (BRAC)

Methods for Assigning Total Cleanup Costs to Current Operating Periods
Active Installations - Defense Environmental Restoration Program (DERP) Funded: Accrued DERP cleanup liabilities represent the cost to correct past releases of hazardous constituents to Property, Plant, and Equipment, including acquired land and Stewardship Land. Environmental cleanup of past releases is funded by DERP and carried out under applicable regulatory laws and procedural guidance..

Environmental restoration activities may be conducted at operating installations under the Installation Restoration Program (IRP) and at Closed, Transferred, and Transferring Munitions Ranges under the Military Munitions Response Program (MMRP). Determining total environmental cleanup cost considers, on a current cost basis, the anticipated actions required to complete the cleanup, as well as applicable legal and/or regulatory requirements. Program management and support costs are also included in the estimates. The estimate produced is based on site-specific information and use of cost models. The cost estimates are developed and maintained in the DON's Normalization of Data System (NORM) database. Such cost estimates are based on the current technology available.

MMRP liabilities are specific to the identification, investigation, removal, and remedial actions to address environmental contamination at ranges that were closed prior to September 30, 2002. The contamination may include munitions, chemical residues from military munitions and munitions scrap at ranges on active installations that pose a threat to human health or the environment. Cost to Complete (CTC) is not estimated until there is sufficient site-specific data available to estimate the total CTC. However, the DON uses the cost of the study as the estimate until the study is completed.

The Accrued environmental restoration costs do not include the costs of environmental compliance, pollution prevention, conservation activities, contamination, or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations.

Environmental Disposal for Weapons Systems Programs: This area represents environmental liabilities associated with the Nuclear Powered Aircraft Carriers and Submarines, Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. During FY 2006, under the DON Financial Improvement Program (FIP), the DON completed a review of the estimating methodology for determining the cost for disposal of ships and submarines. This review resulted in an environmental and non-environmental liability estimate that more accurately reflects the true costs of disposal. The estimating methodology is based on average cost per class of ship rather than an average applied to all ships regardless of class.

Description of the Types of Environmental Liabilities and Disposal Liabilities
Accrued Environmental Restoration Liabilities

The DON environmental cleanup cost estimate was based on 3,919 IRP and 365 MMRP sites at 207 active installations. As of September 30, 2013, the DON estimated and reported $4.7 billion for environmental restoration liabilities. This amount is comprised of $2.7 billion in Active Installations-IRP liabilities and $2.0 billion in Active Installations-MMRP liabilities.

Other Accrued Environmental Liabilities – Non-BRAC

The DON defines Non-BRAC environmental units as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retro fill, and/or disposal of PCB transformers, underground storage tank remedial investigation and closure.

Base Realignment and Closure Installations

BRAC environmental sites are environmental sites at the DON installations that are or will be closed under the congressionally mandated BRAC process. As of September 30, 2013, the DON has estimated and reported $1.51 billion for BRAC funded environmental liabilities. This amount includes $1.4 billion for IRP, $0.1 billion for MMRP, and

$0.01 billion for environmental corrective action and closure requirements. MMRP includes military munitions, chemical residues from military munitions, and munitions scrap at locations on a BRAC installation.

Environmental Disposal for Military Equipment / Weapons Programs

Environmental Disposal for Weapons Systems are those estimates associated with the environmental disposal costs for the DON Nuclear Weapons Programs that include Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to Inflation, Deflation, Technology, or Applicable Laws and Regulations

Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of September 30, 2013, there are no changes to the environmental liability estimates due to changes in laws, regulations, and agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

Description of the Level of Uncertainty Regarding the Accounting Estimates used to calculate the Reported Environmental Liabilities

The environmental liabilities for the DON are based on accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

NOTE 13. OTHER LIABILITIES

As of September 30

(Amounts in thousands)

	2013		
	Current Liability	**Noncurrent Liability**	**Total**
Intragovernmental			
Advances from Others	$ 150,533	$ -	$ 150,533
Disbursing Officer Cash	100,883	-	100,883
Judgment Fund Liabilities	771	-	771
FECA Reimbursement to the Dept. of Labor	165,467	193,509	358,976
Custodial Liabilities	3,708,752	-	3,708,752
Employer Contribution and Payroll Taxes Payable	36,736	-	36,736
Other Liabilities	117,357	-	117,357
Total Intragovernmental	4,280,499	193,509	4,474,008
Accrued Funded Payroll and Benefits	1,528,567	-	1,528,567
Advances from Others	526,004	-	526,004
Deposit Funds and Suspense Accounts	198,608	-	198,608
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	161,461	63,107	224,568
Excess/Obsolete Structures	79,243	218,880	298,123
Accrued Unfunded Annual Leave	3,000,903	-	3,000,903
Contract Holdbacks	516,623	-	516,623
Employer Contribution and Payroll Taxes Payable	23,703	-	23,703
Contingent Liabilities	21,115	2,276,229	2,297,344
Other Liabilities	(79)	-	(79)
Total Other Liabilities	$ 10,336,647	$ 2,751,725	$ 13,088,372

(Amounts in thousands)

	2012		
	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	$ 212,571	$ -	$ 212,571
Deposit Funds and Suspense Account Liabilities	-	-	-
Disbursing Officer Cash	95,170	-	95,170
Judgment Fund Liabilities	6,533	-	6,533
FECA Reimbursement to the Dept. of Labor	162,613	204,193	366,806
Custodial Liabilities	3,526,910	-	3,526,910
Employer Contribution and Payroll Taxes Payable	30,938	-	30,938
Other Liabilities	147,232	-	147,232
Total Intragovernmental	4,181,967	204,193	4,386,160
Accrued Funded Payroll and Benefits	980,016	-	980,016
Advances from Others	493,118	-	493,118
Deposit Funds and Suspense Accounts	262,812	-	262,812
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	151,304	26,488	177,792
Excess/Obsolete Structures	66,094	525,598	591,692
Accrued Unfunded Annual Leave	2,940,264	-	2,940,264
Contract Holdbacks	73,563		73,563
Employer Contribution and Payroll Taxes Payable	21,557		21,557
Contingent Liabilities	15,364	2,610,012	2,625,376
Other Liabilities	6,646	-	6,646
Total Other Liabilities	$ 9,192,705	$ 3,366,291	$ 12,558,996

Intragovernmental Other Liabilities consists primarily of Unemployment Compensation unfunded liabilities.

Contingent Liabilities includes $1.3 billion related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. It is DoD policy that these rights should not be misconstrued as rights of ownership. The DON is under no obligation to pay contractors for amounts greater than the amounts of progress payments authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but not yet paid are estimable, the DON has recognized a contingent liability for the estimated unpaid costs that are considered conditional for payment pending delivery and government acceptance.

The estimate of total contingent liabilities for progress payments are based on cost that represent the difference between the estimated costs incurred to date by contractors and amounts authorized to be paid under progress payments based on cost provisions within the FAR. Estimated contractor-incurred costs are calculated by dividing the cumulative unliquidated progress payments based on cost by the contract-authorized progress payment rate. The balance of unliquidated progress payments based on cost is deducted from the estimated total contractor-incurred costs to determine the contingency amount.

The abnormal balance in non-Federal Other Liabilities is under investigation. It is likely related to ongoing general ledger posting issues to be addressed through audit readiness efforts.

NOTE 14. COMMITMENTS AND CONTINGENCIES

The DON is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON has accrued contingent liabilities for legal actions where the Office of General

Counsel (OGC) considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The DON records contingent liabilities in Note 13, Other Liabilities.

For FY 2013, the DON materiality threshold for reporting litigation, claims, or assessments is $52.1 million. The DON OGC conducts a review of litigation and claims threatened or asserted involving the DON to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The DON currently has 16 cases that meet the existing FY 2013 materiality threshold. The DON legal counsel was unable to express an opinion concerning the likely outcome on 13 of 16 cases.

The DON is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the DON has limited automated system processes by which it captures or assesses these potential liabilities; therefore, the amounts reported may not fairly present the DON's contingent liabilities.

NOTE 15. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30

(Amounts in thousands)

2013	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits				
FECA	$ 1,718,646		$ -	$ 1,718,646
Other	537		(537)	-
Total Other Benefits	$ 1,719,183		$ (537)	$ 1,718,646
Total	$ 1,719,183		$ (537)	$ 1,718,646

As of September 30

(Amounts in thousands)

2012	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits				
FECA	$ 1,670,271		$ -	$ 1,670,271
Other	489		(489)	-
Total Other Benefits	$ 1,670,760		$ (489)	$ 1,670,271
Total	$ 1,670,760		$ (489)	$ 1,670,271

The DON reports an actuarial liability for the Federal Employee's Compensation Act (FECA). FECA provides Federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. FECA is administered by the Office of Workers' Compensation Programs.

The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

Actuarial Cost Method Used and Assumptions:

The DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON only at the end of each fiscal year.

The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period.

NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

As of September 30

(Amounts in thousands)

	2013	2012
Intragovernmental Cost	$ 46,766,773	$ 50,908,881
Nonfederal Cost	109,889,047	129,385,410
Total Cost	$ 156,655,820	$ 180,294,291
Intragovernmental Revenue	$ (2,951,971)	$ (3,312,422)
Nonfederal Revenue	(8,070,917)	(7,287,485)
Total Revenue	$ (11,022,888)	$ (10,599,907)
Total Net Cost	$ 145,632,932	$ 169,694,384

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department of Defense's (DoD) current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4,"Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 30, "Inter-entity Cost Implementation." Intragovernmental costs and revenue represent transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity. The DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Generally Accepted Accounting Principles for federal agencies. Most of the DON's legacy systems were designed to record information on a budgetary basis and do not track intragovernmental transactions by customer at the transaction level. Considering these systems limitations, the DON is unable to accurately compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental trading partners. Buyer-side accounts payable and expenses were adjusted to match seller-side accounts receivable and revenues. This is accomplished by reclassifying amounts between federal and public cost categories, and accruing additional costs when necessary. Intradepartmental revenues and expenses are then eliminated.

In conjunction with the DoD, the DON has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of USGAAP. One such action is the revision of its accounting systems to record transactions based on the U.S. Standard General Ledger. Until such time as all of the DON's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by USGAAP, the DON's financial data will be largely based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

The DON's accounting systems generally do not capture information relative to Heritage Assets separately and distinctly from normal operations.

NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

Unexpended Appropriations represents the amount of spending authorized as of year-end that is unliquidated or unobligated and has not lapsed, been rescinded, or withdrawn.

Cumulative Results of Operations represents the net results of operations since inception. Included as a reduction in Cumulative Results of Operations are accruals for which related expenses require funding from future appropriations. These future funding requirements include, among others (a) accrued annual leave earned but not taken, (b) expenses for contingent liabilities and (c) expenses for environmental liabilities.

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $12.3 billion is due to certain cash receipts recorded as "Appropriations Received" on the SBR but recognized as exchange or non-exchange revenue (usually in special and trust fund accounts) and reported on the SCNP in accordance with SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.

Other Financing Sources - Other consists primarily of gains and losses associated with Military Equipment, Operating Materials & Supplies, and Real Property.

NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30

(Amounts in thousands)

	2013	2012
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 158,004,011	$ 154,814,226

The SBR includes intraentity transactions because the statements are presented as combined.

Apportionment Categories for Obligations Incurred

The direct and reimbursable obligations under Categories A and B are reported in the table below. Apportionment categories are determined in accordance with the guidelines provided in Part 4 "Instructions on Budget Execution" of OMB Circular A-11 Preparation, Submission and Execution of the Budget. Category A represents resources apportioned for calendar quarters and Category B represents resources apportioned for other time periods or for activities, projects, objectives or for a combination thereof.

Permanent, Indefinite Appropriations

The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the U.S.; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet, including the acquisition, alteration or conversion of vessels. There were no transfers out of NDSF during this period.

The Environmental Restoration, Navy (ER, N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. There were 3 transfers from ER, N for $3 billion to the Operation and Maintenance, Navy appropriation. There were no transfers into ER, N during this period.

NOTE 19. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30

(Amounts in thousands)

	2013	2012
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations incurred	$ 178,352,739	$ 194,177,904
Less: Spending authority from offsetting collections and recoveries (-)	(19,223,668)	(21,354,258)
Obligations net of offsetting collections and recoveries	159,129,071	172,823,646
Less: Offsetting receipts (-)	(86,119)	(226,131)
Net obligations	159,042,952	172,597,515
Other Resources:		
Donations and forfeitures of property	6,897	1,742
Transfers in/out without reimbursement (+/-)	(654,769)	(138,094)
Imputed financing from costs absorbed by others	746,117	816,514
Other (+/-)	36,973,812	4,114,238
Net other resources used to finance activities	37,072,057	4,794,400
Total Resources Used to Finance Activities	$ 196,115,009	$ 177,391,915
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders (-)	$ (3,189,785)	$ (6,516,469)
Unfilled Customer Orders	518,632	340,369
Resources that fund expenses recognized in prior periods (-)	(730,358)	(158,378)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	86,119	226,131
Resources that finance the acquisition of assets (-)	(15,379,331)	(15,764,666)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
Other (+/-)	(36,336,129)	(3,977,906)
Total resources used to finance items not part of the Net Cost of Operations	$ (55,030,852)	$ (25,850,919)
Total resources used to finance the Net Cost of Operations	$ 141,084,157	$ 151,540,996
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	$ 50,811	$ 7,230
Increase in environmental and disposal liability	168,218	434,868
Increase in exchange revenue receivable from the public (-)	20,716	139,587
Other (+/-)	141,273	203,339
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	381,018	785,024
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 3,263,335	$ 19,679,709
Revaluation of assets or liabilities (+/-)	(4,940,274)	(4,152,446)
Other (+/-)		
Operating Material and Supplies Used	6,351,889	4,125,346
Other	(507,191)	(2,284,245)
Total Components of Net Cost of Operations that will not Require or Generate Resources	4,167,759	17,368,364
Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$ 4,548,777	$ 18,153,388
Net Cost of Operations	$ 145,632,934	$ 169,694,384

The Reconciliation of Net Cost of Operations to Budget is designed to reconcile the Net Cost of Operations (reported in the Statement of Net Cost) to the current year obligations (reported in the Statement of Budgetary Resources). This reconciliation is required due to the inherent differences in timing and recognition between the accrual proprietary accounting method used to calculate net cost and the budgetary accounting method used to calculate budgetary resources and obligations.

Due to the DON financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. Differences between budgetary and proprietary data are previously identified deficiencies.

The Reconciliation of Net Cost of Operations to Budget is presented as a consolidated statement. However, certain lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated.

NOTE 20. FUNDS FROM DEDICATED COLLECTIONS

As of September 30

(Amounts in thousands)

BALANCE SHEET	2013	2012
ASSETS		
Fund balance with Treasury	$ 23,331	$ 22,722
Investments	8,326	7,968
Total Assets	$ 31,657	$ 30,690
LIABILITIES and NET POSITION		
Other Liabilities	$ 3,894	$ 1,159
Total Liabilities	$ 3,894	$ 1,159
Cumulative Results of Operations	27,762	29,532
Total Liabilities & Net Position	$ 31,656	$ 30,691

For the period ended September 30	2013	2012
STATEMENT OF NET COST		
Program Costs	$ 24,426	$ 19,924
Net Cost of Operations	$ 24,426	$ 19,924

For the period ended September 30	2013	2012
STATEMENT OF CHANGES IN NET POSITION		
Net Position Beginning of the Period	$ 29,156	$ 25,545
Net Cost of Operations	24,426	19,924
Budgetary Financing Sources	23,032	23,911
Change in Net Position	$ (1,394)	$ 3,987
Net Position End of Period	$ 27,762	$ 29,532

Funds from Dedicated Collections are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. The DON currently has four funds from dedicated collections, for which a brief description follows below. There have been no changes in legislation during or subsequent to the reporting period that significantly changes the purpose or that redirects a material portion of the accumulated balances of any of these four funds. Generally, revenues for the DON's funds from dedicated collections are inflows of resources to the Government.

Special Funds from Dedicated Collections

Wildlife Conservation, Military Reservations, Navy

This fund, authorized by 16 United States Code 670b, provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Proceeds from the sale of fishing and hunting permits are used for

these programs at the DON installations charging such user fees. These programs are carried out through cooperative plans agreed upon by the local representatives of the Secretary of Defense, the Secretary of the Interior, and the appropriate agency of the State in which the installation is located.

Trust Funds from Dedicated Collections

The DON General Gift Fund

This fund is authorized by 10 United States Code 2601. Under the provisions of this statute, the Secretary of the Navy (SECNAV) may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that it be used for the benefit, or in connection with the establishment, operation, or maintenance of a school, hospital, library, museum, cemetery, or other institution under the jurisdiction of the DON.

Ships Stores Profit, Navy

This fund is authorized by 10 United States Code 7220. Deposits to this fund are derived from profits realized through the operation of ships' stores and from gifts accepted for providing recreation, amusement, and contentment for enlisted members of the Navy and Marine Corps.

U.S. Naval Academy General Gift Fund

This fund is authorized by 10 United States Code 6973. Under the provisions of this statute, SECNAV may accept, hold, administer, and spend any gift, devise, or bequest of personal property, made on the condition that it be used for the benefit of, or in connection with, the United States Naval Academy, or the Naval Academy Museum, its collections, or its services.

Fund Reclassification

Effective for FY 2013 reporting, the DON has reclassified the Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Trust Fund and the Ford Island Improvement Account in accordance with clarifying language provided by the Statement of Federal Financial Accounting Standards 43: Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, Identifying and Reporting Funds from Dedicated Collection.

The reclassified funds were evaluated against SFFAS 43 and determined to no longer meet the criteria for reporting as "dedicated collections" because the funds' primary source of financing came from the Federal government rather than from the public.

NOTE 21. FIDUCIARY ACTIVITIES

For the period ended September 30

(Amounts in thousands)

	Schedule of Fiduciary Activities	
	2013	**2012**
Fiduciary net assets, beginning of year	$ 30,812	$ 32,769
Contributions	36,617	46,803
Investment earnings	2,335	2,560
Distributions to and on behalf of beneficiaries	(44,859)	(51,320)
Increase/(Decrease) in fiduciary net assets	(5,907)	(1,957)
Fiduciary net assets, end of period	$ 24,905	$ 30,812

For the period ended September 30

(Amounts in thousands)

	Fiduciary Net Assets 2013	Fiduciary Net Assets 2012
Fiduciary Assets		
Cash and cash equivalents	$ 24,905	$ 30,812

Fiduciary activities are the collection or receipt, and management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which Non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

The DON's Fiduciary Activity consists of funds in the Savings Deposit Program. Under 10, USC, §1035, and Department of Defense Financial Management Regulation (FMR), Volume 7A, Chapter 51, service members of both the Navy and Marine Corps who are on a permanent duty assignment outside the United States or its possessions can earn interest at a rate prescribed by the president, not to exceed 10 percent a year, on up to $10 thousand deposited into the program. This limitation shall not apply to deposits made on or after September 1, 1966 in the case of those members in a missing status during the Vietnam conflict, the Persian Gulf conflict, or a contingency operation.

A permanent duty assignment is defined as any active duty assignment that contemplates duty in the designated area as a permanent change of station, or more than 30 days on temporary additional duty, temporary duty, or with a deployed ship or unit. This definition of a permanent duty assignment applies specifically to this program, effective as of July 1, 1991. Interest accrual shall terminate 90 days after the member's return to the United States or its possessions. The deposit funds included in the balance are 17X6025 for Navy and 17X6026 for Marine Corps.

NOTE 22. LEASES

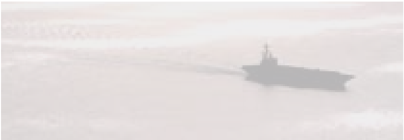
As of September 30

(Amounts in thousands)

	2013 Land and Buildings	2013 Equipment	2013 Other	2013 Total
Entity as Lessee - Operating Leases				
Future Payments Due				
Fiscal Year				
2014	$ 117,022	$ 2,502	$ 39,536	$ 159,060
2015	119,489	2,627	41,266	163,382
2016	122,012	2,758	43,092	167,862
2017	124,593	2,896	45,021	172,510
2018	127,232	3,041	47,059	177,332
After 5 Years	129,931	3,193	49,213	182,337
Total	$ 740,279	$ 17,017	$ 265,187	$ 1,022,483

Department of the Navy Fiscal Year 2013 Annual Financial Report

Required Supplementary Stewardship Information




Investments in Research and Development
Yearly Investment in Research and Development
For Fiscal Years 2009 through 2013

($ in Millions)

Categories	FY13	FY12	FY11	FY10	FY09
Basic Research	$ 556	$ 554	$ 547	$ 552	$ 523
Applied Research	776	738	728	752	854
Development					
Advanced Technology Development	653	761	821	859	883
Advanced Component Development and Prototypes	3,956	3,950	4,080	3,910	3,464
System Development and Demonstration	4,655	5,382	6,429	7,325	8,288
Research, Development, Test, and Evaluation Management Support	1,061	1,298	1,285	1,293	1,245
Operational Systems Development	3,863	4,137	4,285	4,505	4,249
Totals	**$ 15,520**	**$ 16,820**	**$ 18,175**	**$ 19,196**	**$ 19,506**

Investments in Research and Development

Investment values are based on Research and Development (R&D) outlays (expenditures). Outlays are used because current the DON systems are unable to fully capture and summarize costs in accordance with USGAAP.

R&D programs are classified as Basic Research, Applied Research, and Development. The definition of each R&D category and subcategory is explained below.

Basic Research

Basic research is the systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

Basic Research Examples:

Arctic and Global Prediction:

The Office of Naval Research (ONR) Arctic & Global Prediction Program supports basic research focused on expanding the fundamental understanding of key processes of the Arctic environment, the development of new technologies to improve Arctic observational capabilities, and the construction of numerical Arctic System Models that can be used for enhanced understanding and prediction.

Significant sea ice changes that have occurred in recent years in the Arctic Ocean, which has implications for the safety of future U.S. Navy Arctic operations. Consequently, the over-arching goal of the program is to improve coupled Arctic System Models and sea ice prediction at a variety of space and time scales. Three main areas of research are:

<u>Observing Capabilities</u>: The Arctic is a data-sparse region where there remains a need for sensors and sensor systems to operate for extended periods of time in the challenging Arctic environment. The development of new in situ and remote sensing systems will contribute to an Arctic Observing Network that will provide long-term observational data sets that are both useful for the fundamental understanding of Arctic processes and essential for assimilation into and validation of predictive Arctic models.

<u>Fundamental Understanding of Key Physical Processes</u>: The significant retreat of sea ice during recent summers has led to the emergence of new processes in the Arctic. Understanding this "new" environment and the processes governing the retreat and advance of the ice cover is essential. Areas of research include: ocean-ice-atmosphere interactions in the marginal ice zone (MIZ); sea state and boundary layer physics in the emerging Arctic Ocean; wave and swell penetration into the Arctic ice field; sea ice dynamics and mass balance; changes in ocean salinity, temperature and heat storage; atmospheric temperature profiles and cloud properties; and sea spray and icing.

<u>Environmental and Predictive Modeling</u>: The development of improved fully coupled, ocean-wave-ice-atmosphere Arctic system models is a key element in an improved predictive capability. The models must have sufficient resolution

to represent the important processes and to support the assimilation of high resolution in situ and remotely-sensed observations. Improved skill in forecasting the Arctic operational environment is desired, particularly of key variables such as the location of the sea ice edge, the concentration, floe size and thickness of the ice cover, and vertical structure throughout the boundary layer. Coupling of Arctic System Models to Global Earth System Models will be required to capture the physical interactions between the Arctic and lower latitudes.

What this research will accomplish:

- Provides the necessary S&T to enable safe and effective Naval mission planning and execution in the rapidly changing Arctic
- Enhanced Arctic domain awareness and prediction

Structural Metals:

The Structural Metals program emphasizes developing the fundamental understanding needed to design and produce high-strength structural metals. It also establishes the technical feasibility of the technologies to enable platforms and systems with increased performance, reduced weight and reduced cost.

Most recently, this program was responsible for the identification, development and processing qualification of HSLA-65. This high-strength steel alloy has reduced significantly the structural weight of aircraft carriers currently under construction. This program also has enabled certification of aluminum-scandium alloys, developed for high-performance sporting goods, for applications in reconfigurable interior structures in surface combatants. This further reduces ship weight and enables faster maintenance and overhaul.

The Structural Metals program's current focus is on basic and applied research in the areas of advanced naval steel design and production, affordable titanium alloy design and production, and robust, affordable processing and joining technology. The intent of these investments is to:

- Establish an understanding and quantitative description of the mechanisms that define the evolution of a material's structure as a function of composition and processing
- Provide an understanding of the complex and dynamic interactions that modify materials structure and behavior as a function of operational demands and loading events
- Develop characterization and modeling tools, at appropriate length and time scales, to enable the advancement of materials science, including design and predictive capabilities
- Develop technologically feasible transition paths for advanced structural materials and processing and the knowledge needed for the confident design and life prediction of components and systems

What this research will accomplish:

- Provide the warfighter with enhanced structural materials that improve platform survivability, reduce platform weight and improve platform efficiency at reduced life cycle costs.
- Enable affordable, qualified high-performance structural metals and the necessary processing techniques to support their production and fabrication.

Applied Research

Applied research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is the practical application of such knowledge or understanding for the purpose of meeting the recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and defining their parameters. Major outputs are scientific studies, investigations and research papers, hardware components, software codes, and limit construction of, or part of, a weapon system to include non-system-specific development efforts.

Applied Research Examples:

Graphene and Future Nanoelectronics:

Graphene is a single atomic layer of carbon arranged into a hexagonal crystal lattice, first isolated (by splitting graphite) and characterized in 2004 by Professors Andre Geim and Kostya Novoselov of the U.K.'s University of Manchester, earning them the 2010 Nobel Prize in Physics.

Moore's Law predicts that transistors will no longer shrink as quickly beginning in 2020. As a result, ONR is confronted with technical challenges at several levels: materials synthesis and characterization, novel nanodevices circuits, new computing architectures and nanofabrication.

The ONR nanoelectronics program thrusts are specifically designed to address each of those challenges. Since 2005, ONR has been supporting various aspects of graphene research in order to use it as a material platform for future nanoelectronic devices, circuits and systems. For example, one of the key technical issues for graphene-based electronic devices, despite its record mobility, is the lack of an electronic bandgap in bulk graphene (e.g., lateral size of graphene sheet exceeding 1 micron). Early investment in ONR's program focused on various ways to open a bandgap in graphene, such as using graphene nanoribbons or multi-layer graphene.

More recently ONR turned its attention to atomic scale molecular engineering of graphene nanostructures using chemical synthesis techniques. This latter approach, while technically more challenging, holds great potential to change the entire landscape of nanoelectronics beyond the transistor era.

What this research will accomplish:

- Personal electronic aids for individual warfighters that are flexible and lightweight, with extremely low power consumption to enhance battlefield situational awareness
- Electronic components that meet and exceed the size weight and power (SWaP) requirements for real-time information processing onboard small unmanned air vehicles (UAV), thereby unleashing their power in aerial reconnaissance and surveillance missions
- The combination of graphene's superior electronic properties with the other, equally unique, properties in optical (THz to UV), thermal and mechanical domains could lead to completely new and hitherto unforeseen capabilities for both military and civilian applications.

Battlefield Medicine: Advanced Microscopy, Cytometry and Sensing Platforms
Office of Naval Research (ONR) focuses on support of science and technology to enable new biomedical capabilities for use in austere settings. Rugged, miniaturized tools for far-forward diagnosis of infections, or contaminated food and water may save lives in both battlefield and humanitarian aid/disaster relief (HADR) scenarios.

Wide-field Fluorescent Imaging On a Cell Phone: By adding a compact attachment to the existing camera unit of a cellphone, a 20-fold larger field of view (relative to a conventional microscope) can be imaged in fluorescent mode. Fluorescent tagging agents are added to the sample if the specimen is not naturally fluorescent. The images to the right shows a parasite (Giardia lamblia) often found in contaminated water, and labeled white blood cells. The cell-phone images compare well with conventional microscopy images.

Holographic Imaging of Dense Samples (e.g., tissue): Densely packed or 'connected' cells present special challenges for imaging. The solution has been to acquire holographic images from various heights with respect to the sample, in reflection mode. A holographic imaging 'tower' has been design to attach to a cell-phone, enabling high resolution of features in dense samples. New data analysis and processing algorithms allow image reconstruction which is comparable to that obtained with a conventional microscope, as shown with skin samples to the left. These advances may allow remote diagnosis of diseases, infections of food contamination.

Digital Holographic Imaging offers a new, compact and rugged method for analyzing biomedical and other samples in remote locations which compares will with fragile, lens-based microscopies. Integration with a cell-phone platform allows transmission of images to experts located elsewhere for analysis. The impact of this technology is expected to be dramatic, especially in third-world countries where access to sophisticated medical facilities is limited.

What this research will accomplish:

- Provide new capabilities to rapidly conduct various biomedical tests, e.g., blood analysis in the field (including differential cell counts and platelet counts)
- Screen for various pathogens/bacteria (e.g., Escherichia coli, Cryptosporidium) in bodily fluids, food or water using compact, light-weight and cost-effective designs.

Development

Developmental research takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability.

Developmental Research Examples:

Directed Energy:

The Solid State and Fiber laser technology are delivering mature high-energy laser technologies into a prototypical weapon system for use and installation on the Navy's surface combatants and aircraft.
Solid State Laser technology with weapons-level effects has been maturing rapidly, In fact, the Chief of Naval Operations announced the deployment of a SSL laser onboard USS Ponce (AFSB 15) in FY 2014 comes as ONR continues to make significant progress on directed energy weapons, allowing the service to deploy a laser weapon on a ship two years ahead of schedule. The at-sea demonstration in FY 2014 is part of a wider portfolio of near-term Navy directed energy programs that promise rapid fielding, demonstration and prototyping efforts for shipboard, airborne and ground systems.

Directed energy initiatives, and specifically the solid-state laser, are among the highest priority science and technology programs. The solid-state laser program is central to the commitment to quickly deliver advanced capabilities to forward-deployed forces. This capability provides a tremendously affordable answer to the costly problem of defending against asymmetric threats.

The solid-state laser is a revolutionary technology that gives the Navy an extremely affordable, multi-mission weapon with a deep magazine and unmatched precision, targeting and control functions. Because lasers run on electricity, they can be fired as long as there is power and provide a measure of safety as they don't require carrying propellants and explosives aboard ships.

Lasers complement kinetic weapons to create a layered ship defense capability, providing improved protection against swarming small boats and unmanned aircraft at a fraction of the cost of traditional weapons.

The advancing technology gives sailors a variety of options they never had before, including the ability to control a laser weapon's output and perform actions ranging from non-lethal disabling and deterrence all the way up to destruction.

Video of the demonstration of the high-energy laser aboard a moving surface combatant ship and against remotely piloted aircraft can be seen here: *http://youtu.be/OmoldX1wKYQ*

What this research will accomplish:

- Produce a prototypical weapon system for use on surface Navy combatants. Lasers have the capability for speed-of-light engagements, with very precise, real-time targeting and battle damage assessments
- Other directed energy programs include Fiber Lasers and Free Electron Lasers

Electromagnetic Railgun and Hypervelocity Projectile:

The Electromagnetic Railgun launcher is a long-range weapon that fires projectiles using electricity instead of chemical propellants. Magnetic fields created by high electrical currents accelerate a sliding metal conductor, or armature, between two rails to launch projectiles at 4,500 mph to 5,600 mph.

The Electromagnetic Railgun was initiated in 2005 as Innovative Naval Prototype. The Department of the Navy's science and technology corporate board chartered the Innovative Naval Prototype (INP) construct to foster game-changing and disruptive technologies ahead of the normal requirements process.

The program is in Phase II, which started in 2012, and will advance the technology for transition to an acquisition program. Phase II technology efforts will concentrate on demonstrating a rep-rate fire capability up to 10 rounds per minute. Thermal management techniques required for sustained firing rates will be developed for both the launcher system and the pulsed power system.

Railgun will fire a Hypervelocity Projectile. The HVP is a next-generation, common, low-drag, guided projectile capable of completing multiple missions for gun systems such as the Navy 5-inch, 155 mm and future railguns. Types of missions performed will depend on the gun system and platform. The program goal is to address mission requirements

in the areas of naval surface fire support, cruise missile defense, anti-surface warfare and other future naval mission areas. Mission performance will vary from gun system, launcher or ship. The HVP's low-drag, aerodynamic design enables high velocity, maneuverability and decreased time to target. These attributes, coupled with accurate guidance electronics, provide low-cost mission effectiveness against current threats and the ability to adapt to future air and surface threats.

The high-velocity, compact design relieves the need for a rocket motor to extend gun range. Firing smaller, more accurate rounds improves danger close and collateral damage requirements and provides potential for deeper magazines and improved shipboard safety. Responsive wide-area coverage can be achieved using HVP from conventional gun systems and future railgun systems.

The HVP's modular design will allow it to be configured for multiple gun systems and to address different missions. It is being designed to provide lethality and performance enhancements to current and future gun systems. A hypervelocity projectile for multiple systems will allow for future technology growth while reducing development, production and total ownership costs.

What this research will accomplish:

- With its increased velocity and extended range, the EM Railgun will give Sailors a multi-mission capability, allowing them to conduct precise naval surface fire support, or land strikes; cruise missile and ballistic missile defense; and surface warfare to deter enemy vessels.
- The HVP will provide the Navy with the capability to address a variety of current and future naval threats in the mission areas of naval surface fire support, ship defense and anti-surface warfare using current and future gun systems

Marine Corps Examples:

Precision Universal Mortar Attack:

Warfighters capable of being employed in small, distributed units will locate and decisively engage larger enemy forces by applying timely, reliable, precise and accurate fires (kinetic and non-kinetic) from a myriad of platforms. Tactical units will be able to operate well beyond conventional parameters of direct-fire mutual support.

Warfighters will use integrated, lightweight optics and sensors to see through all battlefield conditions (day, night, low light and obscuration), and they will use lightweight, organic, manned and unmanned platforms and advanced weapons for the rapid, accurate, effective application of firepower across the full range of military operations. They also will apply non-organic and joint fires optimally. Increased intelligence capabilities delivered by company intelligence cells will generate more potential targets in the future.

The Precision Universal Mortar Attack (PUMA) Future Naval Capability program is currently the lead program in the Advanced Weapons Technology Investment Area portfolio. PUMA will develop and demonstrate (FY 2014) a Global Positioning System guidance kit for mid-range 120 mm mortar ammunition to provide an addition to the Expeditionary Fire Support System (EFSS) Family of Munitions (FoM). The PUMA Flight Controlled Mortar munitions will provide a precision capability between the upper end of the M1101 HE round range and the lower end of the Precision Extended Range Munition round range. This will enable the EFSS FoM to have a less than 20-meter circular error probability of 50 percent over the entire range of all the system's munitions.

What this research will accomplish:

- Automatic target detection, recognition, identification, tracking and handoff capability at standoff distances in dismounted targeting systems
- Affordable fires accuracy and lethality against small tactical platforms from small manned tactical platforms
- Reduce weight and Improve life cycle performance (reduced barrel erosion, improved operational performance)
- Precision fires for companies

Counter IED Dog Program:
The Naval Expeditionary Dog Program (NEDP) is a holistic science and technology based program investigating ways to optimize the utility of working dogs in current and future operating environments.

Better understanding of the complex relationships between nutrition, hydration, physical conditioning, olfaction, training and cognition will allow us to field a dog that can consistently function as trained even in the challenging environments encountered in war. The objective of the Physical and Cognitive Optimization Technology Investment Area is to investigate underlying features of canine physiology and cognition to deliver knowledge products supporting targeted improvements to canine performance.

NEDP maintains the scientific expertise and relationships with universities that supports rapid, thoughtful answers to urgent questions from the warfighter and the opportunity to test new ideas in limited objective experiments.

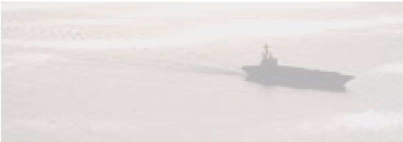
What this research will accomplish:

- Ability to predict, monitor and mitigate effects of canine stress on operational performance
- Canines that can maintain operational tempo in high- and low heat-stress environments and at high altitudes
- Understanding how dogs cognitively process complex odors such as those of homemade explosives
- Better understanding of learning plasticity and stimulus generalization in dogs

Protecting Freedom Under Extraordinary Circumstances

Department of the Navy Fiscal Year 2013 Annual Financial Report

Required Supplementary Information




Department of the Navy
General Property, Plant, and Equipment
Real Property Deferred Maintenance and Repair
For Fiscal Year Ended September 30, 2013

($ in Thousands)

Property Type	1. Plant Replacement Value	2. Required Work (Deferred Maintenance and Repair)	3. Percentage
Category 1: Enduring Facilities			
Navy	$ 145,916	$ 35,638	24.42%
Marine Corps	$ 42,089,348	$ 4,477,670	10.64%
Category 2: Excess Facilities or Planned for Replacement			
Navy	$ 1,259	$ 602	46.82%
Marine Corps	$ 2,145,560	$ -	0.0%
Category 3: Heritage Assets			
Navy	$ -	$ -	-
Marine Corps	$ 4,278,682	$ 455,187	10.64%

NOTE: *In the table above, Navy real property deferred maintenance and repair data represent both Department of the Navy and Navy Working Capital Fund (NWCF). Similarly, Marine Corps real property deferred maintenance and repair data represent both the United States Marine Corps General Fund and NWCF-Marine Corps.*

Description of Property Type categories:

- Category 1 – Buildings, Structures, and Utilities that are enduring and required to support an ongoing mission, including multi-use Heritage Assets.
- Category 2 – Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal, including multi-use Heritage Assets.
- Category 3 – Buildings, Structures, and Utilities that are Heritage Assets.

1. The method used to assess facilities condition is a combination of commercial Infrastructure Condition Assessment Program (ICAP) software and facilities inspection. The Navy's Quality rating (Q-rating) is calculated using the below formula:

$$Q = 1 - \frac{(\text{Requirements})}{\text{PRV}} \times 100$$

The Navy models the "Requirements" value from the condition rating and configuration rating.

The method used to assess facilities conditions is two-fold. All buildings, paving and rail assets are inspection using the Sustainment Management Systems (SMS) methodology developed by the US Army Corps of Engineers Civil Engineering (USACOE) Research Laboratory (CERL) which provides a facilities condition index (FCI) for these assets. Other assets are accessed via facilities inspection, which categorizes buildings as Adequate, Substandard, or Inadequate. Assets inspected using the SMS methodology takes the FCI to determine the asset's Q-rating. Those assets without a direct FCI ratings, the Marine Corps converts the Adequate Substandard and Inadequate ratings to Quality ratings (Q-ratings) of 100%-90% Q1; 90%-80% Q2; 80%-60% Q3; and less than 60% Q4 by assessing facilities that are rated as Adequate and less than 25 years old as Q1; facilities that are over 25 years old and rated as Adequate as Q2; facilities rated as Substandard as Q3; and Inadequate facilities as Q4.

2. The condition rating is a measure (0 -100) of an asset's physical condition at a particular point in time. The Navy uses condition modeling software to capture condition assessment data to model system/component condition ratings. The condition assessment data is supplemented by eyes-on condition assessments that capture accurate facility components and confirm as-built condition. In FY12, the condition assessment program was expanded to include utility systems. Updated condition ratings for utility systems have caused an increase in deferred maintenance and repair backlog.

3. The configuration rating is a measure (0 - 100) of the asset's capability to support the current occupant or mission with respect to functionality. The Configuration Rating is calculated in the internet Navy Facility Assets Data Store

(iNFADS) from an algorithm that weights configuration deficiency codes (code compliance, functional/space criteria, location/siting criteria or inadequate capacity/coverage) collected during Asset Evaluations. Deficiency codes identify impacts to the suitability of spaces for their intended use, including obsolescence of facility components that do not meet new standards.

4. The DON's Q-rating is represented by the bands: 100%-90% Q1; 90%-80% Q2; 80%-60% Q3; and less than 60% Q4.

5. The FY 2012 target Q-rating value representing full investment requirement for the Navy is Q1. The Department of the Navy (DON) follows the Office of the Secretary of Defense installation strategic plan goal of having facilities at a Q2 level on average as an acceptable rating. This represents an average level of 15% of Plant Replacement Value (PRV) as an acceptable level of deferred maintenance. The table above shows that deferred maintenance for the Navy is valued at 28.68%, 45.26% and 0% of PRV for categories 1 through 3, respectively. The deferred maintenance and repair estimates are based on the facility Q-ratings found in the Navy's real property inventory.

   The table above shows that deferred maintenance for Marine Corps is valued at approximately 2.26% of PRV for categories 1 and 3. Category 2 is zero because we do not hold deferred maintenance backlogs on facilities to be demolished.

   The USMC follows the Office of the Secretary of Defense Installation Strategic Plan goal of having facilities at a Q2 level on average as an acceptable rating. This represents an average level of 15% of Plant Replacement Value (PRV) as an acceptable level of deferred maintenance. The table above shows that deferred maintenance is valued at approximately 10.64% of PRV for categories 1 and 3. Category 2 is zero because we do not hold deferred maintenance backlogs on facilities to be demolished.

6. The Facility Readiness Evaluation System (FRES) application was used to generate the Deferred Maintenance and Repair Report. FRES is updated with iNFADS data on a weekly basis and at the end of the fiscal year. The PRV and deferred maintenance and repair estimates for all three categories are reported for CNIC installations only, and only the Maintenance Fund Sources listed below are included. Facilities maintained by BUMED, defense agencies and Family Housing, Navy are excluded from the estimates.
   - Operation and Maintenance, Navy
   - Operation and Maintenance, Navy Reserve
   - Research, Development, Test, and Evaluation
   - Navy Working Capital Fund

7. Category 1 excludes facilities identified in Categories 2 and 3. The Navy currently identifies Category 2 facilities as follows: facilities assigned a RPA Operational Status Code of excess or surplus and RPA Interest Type Code Fee, ONST, ONFG, or Lease. Excess is defined as "property under the control of a Federal agency that the head of the agency determines is not required to meet the agency's needs or responsibilities." The source for this definition is CFT Title 40 USC 102. Category 3 includes facilities that are single-use Heritage Assets. iNFADS does not identify any Navy facilities as single-use Heritage Assets; therefore, the amounts recorded for this category are zero.

Military Equipment Deferred Maintenance
For Fiscal Year Ended September 30, 2013

($ in Thousands)

Major Category	OP30 Amounts	Adjustments	Totals
1. Aircraft	325,525	(108,074)	$217,451
2. Automotive Equipment	3,346	-	3,346
3. Combat Vehicles	6,641	6,800	13,441
4. Construction Equipment	5,952	-	5,952
5. Electronics and Communications Systems	4,854	13,951	18,805
6. Missiles	55,516	60,999	116,515
7. Ships	316,148	391,447	707,595
8. Ordinance Weapons and Munitions	20,186	40,011	60,197
9. All Other Items Not Identified Above	24,636	(12,953)	11,683
Total	**$762,804**	**$392,181**	**$1,154,985**

NOTE: *The deferred maintenance amounts reported in the Budget Exhibit Operations (OP) Depot Maintenance (30) that accompanied the most recent President's Budget was used as the basis to identify and report amounts in the Military Equipment Deferred Maintenance. Material amounts of deferred maintenance beyond the scope of the OP-30 Budget Exhibit, that warrant reporting are in the "Adjustments" column.*

Aircraft Deferred Maintenance
Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), component repair, and software maintenance. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircraft that have reached their Fixed Induction Date (FID) or that have failed an Aircraft Service Period Adjustment (ASPA) inspection at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance represents the difference between the validated requirements minus corresponding funding.

Airframe rework and maintenance (active and reserve) is currently performed under the Integrated Maintenance Concept (IMC) program. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, but with smaller work packages, thereby reducing out-of-service time. The goal of this program is to improve readiness while reducing operating and support costs. The Naval Air Systems Command's (NAVAIR) Industrial Strategy is to maintain the minimum level of organic capacity consistent with force levels that is necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR works in partnership with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance.

Combat Vehicles Deferred Maintenance
The combat vehicles category refers to deferred vehicle maintenance for the active and reserve Marine Corps assets. The combat vehicle category consists of weapons systems such as the M1A1 Tank, the Amphibious Assault Vehicle, the Hercules Recovery Vehicle, and the Light Armored Vehicle. The total requirement is the planned quantity of combat vehicles that require depot level maintenance in a year as determined by program managers and the operating forces with requirements validated by a modeling process. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Missiles Deferred Maintenance
Four categories are used to determine missile maintenance: missiles, tactical missiles, software maintenance, and other. Deferred maintenance is defined as the difference between the total weapon maintenance requirement as determined by requirements modeling processes and the weapon maintenance that is funded in accordance with the annual budget controls for the missile maintenance program. The maintenance requirements model projects the quantity of missiles and missile components per weapon system that are required to be maintained or reworked annually.

Ships Deferred Maintenance
Fleet Type Commanders provide deferred ship maintenance data. Data is collected from the Current Ships' Maintenance Plan (CSMP) database, which captures maintenance actions at all levels (organizational, intermediate, depot) for active and reserve ships. Only depot level deferred maintenance is provided in the calculation of ship deferred maintenance. This includes maintenance actions deferred from actual depot maintenance work-packages as well as maintenance deferred before inclusion in a work package due to fiscal, operational, or capacity constraints. Although there are some

deferred maintenance actions, no ships fall into the category of "unacceptable operating condition." Any ship that would be at risk of being in unacceptable operating condition would receive priority for maintenance funding to maintain acceptable operating condition.

Ordnance Weapons and Munitions Deferred Maintenance
Ordnance weapons and munitions are part of a broader category, Other Weapons Systems. This category is comprised of ordnance, end item maintenance for support equipment, camera equipment, landing aids, calibration equipment, air traffic control equipment, target systems, expeditionary airfield equipment, special weapons, target maintenance, and repair of repairable components. Three categories define ordnance maintenance: ordnance maintenance, software maintenance, and other. Although the various programs vary in the methodology in defining requirements, all programs define deferred maintenance as the difference between validated requirements and funding.

Electronics and Communications Systems
The electronics and communications systems category refers to deferred systems maintenance for active and reserve Navy and Marine Corps assets. This category consists of maintenance performed on a variety of radar, radio, and wire and communications equipment. In part, the systems include or are associated with the Surveillance Towed-Array Sensor System (SURTASS), P-3 Beartrap, satellite subsystems, the Multi-Band Deployable Antenna, the Multi-Mode Inter/Intra Team Radio, and a variety of radio and radar sets used within the Department of the Navy. The total requirement is the planned quantity of systems and their components that require depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is then the difference between the validated requirements and funding received for that fiscal year.

Construction Equipment
The construction equipment category refers to deferred equipment maintenance for active and reserve Marine Corps assets. This category consists of maintenance performed on a variety of tractors and earth moving equipment. In part, the equipment includes the Aardvark Tactical, the 277C Multi-Terrain Loader, the Medium Crawler Tractor, the Armored Excavator with Brush Hog, and Bridge Erection equipment. The total requirement is the planned quantity of equipment that requires depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Deferred Maintenance on All Other Items Not Identified Above
This category comprises deferred maintenance for software, arrest gear, lighting and surfacing equipment, and EFTM (external fuel transfer module). The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Software maintenance includes the operational and system test software that runs in the airborne avionics systems (e.g., mission computer, display computer, radar) and the software that runs the ground-based support labs used to perform software sustainment (e.g., compilers, editors, simulation, configuration management).

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

For the Years Ended September 30, 2013 and 2012

($ in Thousands)

	Research, Development, Test & Evaluation	Procurement	Military Personnel	Family Housing & Military Construction
Budgetary Resources:				
Unobligated Balance, Brought Forward, October 1	$ 2,700,672	$ 24,154,367	$ 799,516	$ 2,601,765
Recoveries of Prior Year Unpaid Obligations	584,325	4,575,242	1,496,416	777,892
Other Changes in Unobligated Balance	(114,532)	(514,121)	(62,361)	(86,226)
Unobligated Balance from Prior Year Budget Authority, net	3,170,465	28,215,488	2,233,571	3,293,431
Appropriations	15,174,174	40,830,148	46,182,522	1,614,378
Spending Authority from Offsetting Collections	183,382	931,190	395,069	626,722
Total Budgetary Resources	$ 18,528,021	$ 69,976,826	$ 48,811,162	$ 5,534,531
Status of Budgetary Resources:				
Obligations Incurred	$ 16,011,743	$ 49,321,199	$ 47,577,892	$ 2,543,907
Unobligated Balance, End of Year				
Apportioned	2,173,401	19,568,400	329,656.00	2,857,785
Exempt from Apportionment	-	-	-	-
Unapportioned	342,878	1,087,228	903,614.00	132,839
Unobligated Balance Brought Forward, End of Year	2,516,279	20,655,628	1,233,270	2,990,624
Total Budgetary Resources	$ 18,528,022	$ 69,976,827	$ 48,811,162	$ 5,534,531
Change in Obligated Balance:				
Unpaid Obligations				
Unpaid Obligations, Brought Forward, October 1	$ 10,270,245	$ 69,088,860	$ 2,661,105	$ 5,247,579
Obligations Incurred	16,011,743	49,321,199	47,577,892	2,543,907
Outlays, gross	(15,717,839)	(43,717,721)	(45,007,119)	(3,476,541)
Recoveries of Prior Year Unpaid Obligations	(584,325)	(4,574,242)	(1,496,416)	(777,892)
Unpaid Obligations, End of Year, gross	9,979,824	70,117,097	3,735,462	3,537,053
Uncollected payments				
Uncollected Payments from Federal Sources, Brought Forward, October 1	(117,614)	(213,516)	(5,399)	(541,761)
Change in Uncollected Customer Payments from Federal Sources	(20,100)	(109,874)	(29,665)	190,410
Uncollected Payments from Federal Sources, End of Year	(137,714)	(323,391)	(35,064)	(351,350)
Obligated Balance, Start of Year	10,152,631	68,875,344	2,655,706	4,705,818
Obligated Balance, End of Year	$ 9,842,110	$ 69,793,706	$ 3,700,398	$ 3,185,703
Budget Authority and Outlays, Net:				
Budget Authority, gross	$ 15,357,556	$ 41,761,339	$ 46,577,591	$ 2,241,100
Actual Offsetting Collections	(163,282)	(821,316)	(365,403)	(817,132)
Change in Uncollected Customer Payments from Federal Sources	(20,100)	(109,874)	(29,665)	190,410
Budget Authority, net	$ 15,174,174	$ 40,830,149	$ 46,182,523	$ 1,614,378
Outlays, gross	$ 15,717,839	$ 43,717,721	$ 45,007,119	$ 3,476,541
Actual Offsetting Collections	(163,282)	(821,316)	(365,403)	(817,132)
Outlays, net	15,554,557	42,896,405	44,641,716	2,659,409
Distributed Offsetting Receipts	-	-	-	-
Agency Outlays, net	$ 15,554,557	$ 42,896,405	$ 44,641,716	$ 2,659,409

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

For the Years Ended September 30, 2013 and 2012

($ in Thousands)

	Operations, Readiness & Support	2013 Combined	2012 Combined
Budgetary Resources:			
Unobligated Balance, Brought Forward, October 1	$ 2,293,395	$ 32,549,715	$ 33,205,881
Recoveries of Prior Year Unpaid Obligations	4,432,353	11,866,228	13,249,015
Other Changes in Unobligated Balance	(1,178,749)	(1,955,989)	(1,337,751)
Unobligated Balance from Prior Year			
Budget Authority, net	5,546,999	42,459,954	45,117,145
Appropriations	58,040,058	161,841,280	173,505,214
Spending Authority from Offsetting Collections	5,231,265	7,367,628	8,105,260
Total Budgetary Resources	$ 68,818,322	$ 211,668,862	$ 226,727,619
Status of Budgetary Resources:			
Obligations Incurred	$ 62,897,998	$ 178,352,739	$ 194,177,904
Unobligated Balance, End of Year			
Apportioned	3,302,562	28,231,804	28,451,635
Exempt from Apportionment	20,725	20,725	-
Unapportioned	2,597,036	5,063,595	4,098,080
Unobligated Balance Brought Forward, End of Year	5,920,323	33,316,124	32,549,715
Total Budgetary Resources	$ 68,818,321	$ 211,668,863	$ 226,727,619
Change in Obligated Balance:			
Unpaid Obligations			
Unpaid Obligations, Brought Forward, October 1	$ 25,659,667	$ 112,927,456	$ 107,478,038
Obligations Incurred	62,897,998	178,352,739	194,177,904
Outlays, gross	(59,015,904)	(166,935,124)	(175,479,471)
Recoveries of Prior Year Unpaid Obligations	(4,432,353)	(11,865,228)	(13,249,015)
Unpaid Obligations, End of Year, gross	25,109,408	112,478,844	112,927,456
Uncollected payments			
Uncollected Payments from Federal Sources, Brought Forward, October 1	(1,751,514)	(2,629,804)	(2,509,887)
Change in Uncollected Customer Payments from Federal Sources	(630,463)	(599,692)	(119,916)
Uncollected Payments from Federal Sources, End of Year	(2,381,976)	(3,229,495)	(2,629,803)
Obligated Balance, Start of Year	23,908,153	110,297,652	104,968,151
Obligated Balance, End of Year	$ 22,727,432	$ 109,249,349	$ 110,297,653
Budget Authority and Outlays, Net:			
Budget Authority, gross	$ 63,271,323	$ 169,208,909	$ 181,610,474
Actual Offsetting Collections	(4,600,803)	(6,767,936)	(7,985,345)
Change in Uncollected Customer Payments from Federal Sources	(630,463)	(599,692)	(119,916)
Budget Authority, net	$ 58,040,057	$ 161,841,281	$ 173,505,213
Outlays, gross	$ 59,015,904	$ 166,935,124	$ 175,479,471
Actual Offsetting Collections	(4,600,803)	(6,767,936)	(7,985,345)
Outlays, net	54,415,101	160,167,188	167,494,126
Distributed Offsetting Receipts	(86,119)	(86,119)	(226,131)
Agency Outlays, net	$ 54,328,982	$ 160,081,069	$ 167,267,995

Protecting Freedom Under Extraordinary Circumstances

Department of the Navy Fiscal Year 2013 Annual Financial Report

Other Accompanying Information

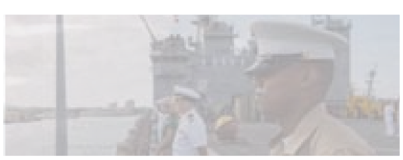



Table 1. Summary of Financial Statement Audit

Audit Opinion	Disclaimer					
Restatement	No					
Areas of Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Financial Management Systems	1	0	0	0	0	1
Fund Balance with Treasury	1	0	0	0	0	1
Accounts Receivable	1	0	0	0	0	1
Other Assets	1	0	0	0	0	1
Inventory and Related Property, Net	1	0	0	0	0	1
General Property, Plant and Equipment	1	0	0	0	0	1
Accounts Payable	1	0	0	0	0	1
Statement of Net Cost	1	0	0	0	0	1
Problem Disbursements	1	0	0	0	0	1
Unobligated Balances	1	0	0	0	0	1

Table 2. Summary of Management Assurances

The DON Operational Material Weaknesses						
Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Qualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Uncorrected Material Weaknesses Identified During Prior Periods						
Service Contracts	1	0	0	0	0	1
Attenuating Hazardous Noise in Acquisition & Weapon System Design	1	0	0	0	0	1
Management of Communications Security (COMSEC) Equipment	1	0	0	0	0	1
Safeguarding Personally Identifiable Information (PII)	1	0	0	0	0	1
Effective Use of Earned Value Management (EVM) Across Shipbuilding Programs	1	0	0	0	0	1
Total Material Weaknesses	5	0	0	0	0	5

The DON Financial Reporting / Financial Systems Material Weaknesses						
Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Uncorrected Material Weaknesses Identified During Period Periods						
Reimbursable Work Orders – Performer, Order-to-Cash	5	0	0	0	0	5
Reimbursable Work Orders – Grantor, Procure-to-Pay	4	0	0	0	0	4
Existence and Completeness	5	0	0	0	0	5
Uncorrected Material Weaknesses Identified During the Period						
Financial Statement Compilation and Reporting	0	1	0	0	0	1
Contract Vendor Pay	0	1	0	0	0	1
Military Standard Requisitioning and Issue Procedures	0	3	0	0	0	3
Transportation of Things	0	3	0	0	0	3
Material Weaknesses Corrected During the Period						
Fund Balance with Treasury	1	0	1	0	0	0
Reimbursable Work Orders – Performer and Grantor (with the exception of Post Collection and Post Disbursement Validation, Year-End Accrual, Tri-annual Review, and Trading Partner Number Reconciliation)	6	0	6	0	0	0
Transportation of People	1	0	1	0	0	0
Total Material Weaknesses	22	8	8	0	0	22

The DON Financial Reporting / Financial Systems Nonconformance						
Conformance with Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	No Assurance					
Nonconformance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Financial System	0	1	0	0	0	1
Total Nonconformance	0	1	0	0	0	1
Conformance with Federal Financial Management Improvement Act (FFMIA)						
Overall Substantial Compliance	No Assurance					

USMC Financial Reporting / Financial Systems Material Weaknesses						
Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	No Assurance					
Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Qualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Military Equipment Assets	1	0	0	0	0	1
Real Property Assets	1	0	0	0	0	1
Contracts	1	0	0	0	0	1
Standard Accounting, Budgeting and Reporting System (SABRS)	1	0	0	0	0	1
Marine Corps Total Force System (MCTFS)	1	0	0	0	0	1
Defense Departmental Reporting System (DDRS)	1	0	0	0	0	1
Defense Cash Accountability System (DCAS)	1	0	0	0	0	1
Total Material Weaknesses	7	0	0	0	0	7
Conformance with Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	No Assurance					
Conformance with Federal Financial Management Improvement Act (FFMIA)						
Overall Substantial Compliance	No Assurance					

Appropriations, Funds, and Accounts Included in the Principal Statements

Entity Accounts

General Funds

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1000	Medicare-Eligible Retiree Health Fund Contribution, Navy
17 1001	Medicare-Eligible Retiree Health Fund Contribution, Marine Corps
17 1002	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy
17 1003	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps
17X1105	Military Personnel, Marine Corps
17 1105	Military Personnel, Marine Corps
17X1106	Operations and Maintenance, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps
17 1109	Procurement, Marine Corps
17 1116	Operation and Maintenance - Recovery Act, Marine Corps
17 1117	Operation and Maintenance - Recovery Act, Marine Corps Reserve
17X1205	Military Construction, Navy and Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1206	Military Construction - Recovery Act, Navy and Marine Corps
17 1235	Military Construction, Naval Reserve
17X1236	Payments to Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
17 1319	Research, Development, Test, and Evaluation, Navy
17 1320	Research, Development, Test and Evaluation - Recovery Act, Navy
17 1405	Reserve Personnel, Navy
17X1453	Military Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17X1507	Weapons Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17X1611	Shipbuilding and Conversion, Navy
17 1611	Shipbuilding and Conversion, Navy
17X1804	Operation and Maintenance, Navy
17 1804	Operation and Maintenance, Navy
17 1805	Operation and Maintenance - Recovery Act, Navy
17X1806	Operations and Maintenance, Navy Reserve
17 1806	Operation and Maintenance, Navy Reserve
17 1807	Operation and Maintenance - Recovery Act, Navy Reserve
17X1810	Other Procurement, Navy
17 1810	Other Procurement, Navy

Revolving Funds

17X4557	National Defense Sealift Fund, Navy
17 4557	National Defense Sealift Fund, Navy

Trust Funds

17X8716	Department of the Navy General Gift Fund
17X8723	Ships Stores Profits, Navy
17X8733	United States Naval Academy General Gift Fund
17X5095	Wildlife Conservation, etc., Military Reservations, Navy
17X5185	Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy (Discontinued)
17X5562	Ford Island Improvement Account

The DON Non- Entity Accounts

Deposit Funds

17X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)
17X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)
17X6025	Pay of the Navy, Deposit Fund (T)
17X6026	Pay of the Marine Corps, Deposit Fund (T)
17X6075	Withheld Allotment of Compensation for Payment of Employee Organization Dues, Navy
17X6083	Withheld Allotment of Compensation for Charitable Contributions, Navy
17X6134	Amounts Withheld for Civilian Pay Allotments, Navy
17X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
17X6705	Civilian Employees Allotment Account, Navy
17X6706	Commercial Communication Service, Navy
17 6763	Gains and Deficiencies on Exchange Transactions, Navy
17X6850	Housing Rentals, Navy
17X6999	Accounts Payable, Check Issue Underdrafts, Navy

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Navy Working Capital Fund Principal Statements




Marines load tanks into a Landing Craft Utility to maintain an amphibious force in readiness. (Photo by Cpl. Ed Galo)

PRINCIPAL STATEMENTS

The Fiscal Year 2013 Navy Working Capital Fund (NWCF) principal statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the NWCF for the fiscal year ending September 30, 2013, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2012.

The following statements comprise the NWCF principal statements:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources

The principal statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the principal statements.

CONSOLIDATED BALANCE SHEET

As of September 30, 2013 and 2012

($ in Thousands)

	2013 Consolidated	2012 Consolidated
ASSETS		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 1,481,951	$ 1,334,582
Accounts Receivable (Note 4)	1,317,180	1,083,381
Other Assets (Note 5)	46	10
Total Intragovernmental	2,799,177	2,417,973
Cash and Other Monetary Assets (Note 6)	11,664	295
Accounts Receivable, Net (Note 4)	64,829	43,326
Inventory and Related Property, Net (Note 7)	21,705,416	20,485,300
General Property, Plant, and Equipment, Net (Note 8)	2,156,351	2,234,480
Other Assets (Note 5)	2,061,527	1,628,448
TOTAL ASSETS	$ 28,798,964	$ 26,809,822
LIABILITIES		
Intragovernmental:		
Accounts Payable (Note 10)	$ 192,102	$ 184,615
Other Liabilities (Note 11 & Note 12)	342,043	531,429
Total Intragovernmental	534,145	716,044
Accounts Payable (Note 10)	3,741,192	3,015,987
Federal Employee and Veteran Benefits (Note 14)	774,032	757,427
Other Liabilities (Note 11 & Note 12)	1,368,691	1,281,831
TOTAL LIABILITIES	6,418,060	5,771,289
Commitments and Contingencies (Note 13)		
NET POSITION		
Unexpended Appropriations - Other Funds	25,307	1,607
Cumulative Results of Operations - Other Funds	22,355,597	21,036,926
TOTAL NET POSITION	$ 22,380,904	$ 21,038,533
TOTAL LIABILITIES AND NET POSITION	$ 28,798,964	$ 26,809,822

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2013 and 2012

($ in Thousands)

	2013 Consolidated	2012 Consolidated
Gross Program Costs		
Gross Costs		
Operations, Readiness, & Support	$ 28,957,181	$ 35,470,797
Less: Earned Revenue	(26,590,168)	(33,425,738)
Net Cost of Operations	$ 2,367,013	$ 2,045,059

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2013 and 2012

($ in Thousands)

	2013 Consolidated	2012 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balance	$ 21,036,926	$ 20,537,742
Budgetary Financing Sources:		
Appropriations Used	500	(353)
Other Financing Sources:		
Transfers-In/Out without Reimbursement	461,027	341,583
Imputed Financing	515,872	538,390
Other	2,708,285	1,664,623
Total Financing Sources	3,685,684	2,544,243
Net Cost of Operations	2,367,013	2,045,059
Net Change	1,318,671	499,184
Cumulative Results of Operations	22,355,597	21,036,926
UNEXPENDED APPROPRIATIONS		
Beginning Balance	1,607	1,254
Budgetary Financing Sources:		
Appropriations Received	24,200	
Appropriations Used	(500)	353
Total Budgetary Financing Sources	23,700	353
Unexpended Appropriations	25,307	1,607
Net Position	22,380,904	21,038,533

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2013 and 2012

($ in Thousands)

		2013 Combined		2012 Combined
Budgetary Resources:				
Unobligated Balance, Brought Forward, October 1	$	3,734,496	$	3,164,084
Recoveries of Prior Year Unpaid Obligations		1,578,395		1,870,102
Other Changes in Unobligated Balance		(1,062,445)		(1,448,900)
Unobligated Balance from Prior Year				
Budget Authority, net		4,250,446		3,585,286
Appropriations		24,200		
Contract Authority		8,112,646		8,929,539
Spending Authority from Offsetting Collections		20,103,185		21,659,085
Total Budgetary Resources	$	32,490,477	$	34,173,910
Status of Budgetary Resources:				
Obligations Incurred	$	28,855,188	$	30,439,413
Unobligated Balance, End of Year				
Apportioned		3,580,527		3,694,934
Unapportioned		54,761		39,563
Unobligated Balance Brought Forward, End of Year		3,635,288		3,734,497
Total Budgetary Resources	$	32,490,476	$	34,173,910
Change in Obligated Balance:				
Unpaid Obligations				
Unpaid Obligations, Brought Forward, October 1	$	12,494,010	$	12,119,020
Obligations Incurred		28,855,188		30,439,413
Outlays, gross		(26,833,547)		(28,194,322)
Recoveries of Prior Year Unpaid Obligations		(1,578,395)		(1,870,102)
Unpaid Obligations, End of Year, gross		12,937,256		12,494,009
Uncollected payments				
Uncollected Payments from Federal Sources, Brought Forward, October 1		(12,674,310)		(10,846,546)
Change in Uncollected Customer Payments from Federal Sources		(1,139,883)		(1,827,764)
Uncollected Payments from Federal Sources, End of Year		(13,814,193)		(12,674,310)
Obligated Balance, Start of Year	$	(180,300)	$	1,272,474
Obligated Balance, End of Year	$	(876,937)	$	(180,301)
Budget Authority and Outlays, Net:				
Budget Authority, gross	$	28,240,031	$	30,588,623
Actual Offsetting Collections		(26,956,716)		(28,281,117)
Change in Uncollected Customer Payments from Federal Sources		(1,139,883)		(1,827,764)
Budget Authority, net	$	143,432	$	479,742
Outlays, gross	$	26,833,547	$	28,194,322
Actual Offsetting Collections		(26,956,716)		(28,281,117)
Outlays, net		(123,169)		(86,795)
Agency Outlays, net	$	(123,169)	$	(86,795)

The accompanying notes are an integral part of the statements.

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON), Navy Working Capital Fund (NWCF), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the NWCF in accordance with, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board; the Office of Management and Budget (OMB) Circular No. A-136, Financial Reporting Requirements; and the Department of Defense (DoD), Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the NWCF is responsible unless otherwise noted.

The NWCF is unable to fully implement all elements of USGAAP and OMB Circular No. A-136, due to limitations of financial and nonfinancial management processes and systems that support the financial statements. The NWCF derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with USGAAP. The NWCF continues to implement process and system improvements addressing these limitations. The DON is currently converting legacy systems to Navy Enterprise Resource Planning (ERP) and developing plans to ensure accurate and complete financial records.

As of the 4th quarter, fiscal year 2013 financial statements, the DoD identified 13 auditor identified material weaknesses, as follows: (1) Financial Management Systems; (2) Fund Balance With Treasury; (3) Financial Reporting of Plan to Perform/Order to Cash; (4) Financial Reporting of Inventory; (5) Financial Reporting of Operating Materials and Supplies; (6) Financial Reporting of Real Property and General Equipment; (7) Accounts Payable; (8) Other Liabilities; (9) Statement of Budgetary Resources; (10) Intragovernmental Eliminations; (11) Unsupported Accounting Entries; (12) Statement of Net Cost; (13) Reconciliation of Net Cost of Operations to Budget.

The FY 2012 financial statements were reclassified to conform to the FY 2013 financial statement presentation requirements. Changes to the presentation of the Combined and Combining Statements of Budgetary Resources were made, in accordance with guidance provided in OMB Circular No. A-136, Financial Reporting Requirements, and as such, activity and balances reported on the FY 2012 Combined and Combining Statement of Budgetary Resources have been reclassified to conform to the presentation in the current year. Certain other prior year amounts have also been reclassified to conform to the current year presentation. The reclassifications had no material effect on total assets, liabilities, net position, change in net position, or budgetary resources as previously reported.

Subsequent events and transactions occurring after September 30, 2013 through the date of the auditors' opinion should be evaluated for potential recognition or disclosure in the financial statements. However, the DON is not yet able to implement this requirement. The date of the auditors' opinion also represents the date that the financial statements were available to be issued.

1.B. Mission of the Reporting Entity

The DON was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The overall mission of the DON is to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression, and maintaining freedom of the seas. The NWCF provides goods, services, and infrastructure to the DON and other DoD customers to help ensure our military forces are mobile, ready, and have the most advanced technology.

The NWCF is a revolving fund that finances the DON activities providing products and services on a reimbursable basis, based on a relationship between operating units and NWCF support organizations. Customers send funded orders to the NWCF providers who furnish the services or products, pay for incurred expenses, and bill the customers, who in turn authorize payment. NWCF activities strive to break even over the budget cycle. NWCF has five programs: Depot Maintenance, Supply Management, Research and Development, Base Support, and Transportation.

1.C. Appropriations and Funds

NWCF received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations which result in transactions that flow through the fund. The NWCF furnishes goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action.

At various times, Congress provides additional appropriations to supplement the NWCF as an infusion of cash when revenues are inadequate to cover costs within the corpus. In FY 2013, the NWCF received appropriations for Hurricane Sandy-related expenses.

1.D. Basis of Accounting

The NWCF's financial management systems are unable to meet all full accrual accounting requirements. Many of the NWCF's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by USGAAP. Most of NWCF's financial and nonfinancial legacy systems were designed to record information on a proprietary basis.

Although the accrual basis of accounting is not fully implemented, under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Under the budgetary basis, however, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

The NWCF financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the NWCF sub-entities. The underlying data is largely derived from proprietary transactions from nonfinancial feeder systems and accruals made for major items such as payroll expenses, accounts payable, Federal Employees' Compensation Act (FECA) liabilities, and revenue. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated NWCF level, these abnormal balances may not be evident. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

The DoD is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the conversion of the DON's legacy systems to Navy ERP which is designed to modernize and standardize Navy's business practices. Navy ERP was developed utilizing the USSGL account structure to better comply with applicable financial management requirements. Until all NWCF financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by USGAAP, financial data will be derived from proprietary transactions, data from nonfinancial feeder systems, and accruals.

The preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

1.E. Revenues and Other Financing Sources

Depot Maintenance NWCF activities recognize revenue according to the percentage of completion method. Supply Management NWCF activities recognize revenue from the sale of inventory items. Research and Development NWCF activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Base Support NWCF activities recognize revenue at the time service is rendered. Transportation NWCF activities recognize revenue on either a reimbursable or per diem basis. The majority of per diem projects are billed and collected in the month services are rendered. The remaining per diem projects accrue revenue in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered.

The NWCF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in the amount reported in the Statement of Net Cost. The U.S. has cost-sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items, such as payroll expenses, accounts payable, FECA liabilities, and revenue. OM&S, operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses. Under the consumption method, OM&S would be expensed when consumed. Due to system limitations, some expenditures for capital and other long-term assets may be recognized as operating expenses. The NWCF continues to implement process and system improvements to address these limitations.

1.G. Accounting for Intragovernmental Activities

Accounting standards require that an entity eliminates intraentity activity and balances from consolidated financial statements in order to prevent overstatement for business with itself. However, the NWCF cannot accurately identify intragovernmental transactions by customer because NWCF's systems do not track buyer and seller data at the transaction level. Generally, seller entities within the DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances and are then eliminated. The DoD is implementing replacement systems and a standard financial information structure that will incorporate the necessary elements that will enable DoD to correctly report, reconcile, and eliminate intragovernmental balances.

The Treasury Financial Manual Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government", provide guidance for reporting and reconciling intragovernmental balances. While NWCF is unable to fully reconcile intragovernmental transactions with all Federal agencies, NWCF is able to reconcile balances pertaining to FECA transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The NWCF's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to Federal agencies. The NWCF's financial statements do not report any public debt, interest, or source of public financing, whether from issuance of debt or tax revenues.

1.H. Transactions with Foreign Governments and International Organizations

Each year, NWCF sells defense articles and services to foreign governments and international organizations under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the Federal Government. Payment in U.S. dollars is required in advance.

1.I. Funds with the U.S. Treasury

The NWCF's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the NWCF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis DFAS performs a reconciliation between NWCF's FBWT and the U.S. Treasury.

1.J. Cash and Other Monetary Assets

Cash is the total of cash resources under the control of NWCF which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions.

1.K. Accounts Receivable

Accounts receivable from other Federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. In accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities, the methodology for losses due to uncollectible amounts are based on an individual account analysis and/or group analysis. The analysis is based on three years of receivable data. This data is used to determine the historical percentage of collections in each age category of receivables. The NWCF does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual Part 2, Chapter 4700, Appendix 10, "Intragovernmental Business Rules".

1.L. Inventories and Related Property

The NWCF values approximately 99% of its resale inventory using the Moving Average Cost (MAC) method. The NWCF reports the remaining 1% of resale inventories at an approximation of historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The LAC method is used because legacy inventory systems were designed for materiel management rather than accounting. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, Accounting for Inventory and Related Property. Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). The NWCF is continuing to transition the balance of the inventories to the MAC method through the implementation of Navy ERP. Most transitioned balances, however, were not base-lined to auditable historical cost and remain noncompliant with SFFAS No. 3.

The NWCF manages only military or government-specific materiel under normal conditions. Items commonly used in and available from the commercial sector are not managed in NWCF's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The NWCF holds materiel based on military need and support for contingencies. The DoD is currently developing a methodology to be used to account for "inventory held for sale" and "inventory held in reserve for future sale" under the provisions of SFFAS No. 3, Accounting for Inventory and Related Property.

Related property includes OM&S. NWCF OM&S is categorized as operating material and supplies held for use. The OM&S is valued at LAC. The NWCF uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, NWCF uses the purchase method. Under this method, material and supplies are expensed when purchased. During FY 2013 and FY 2012, NWCF expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

The NWCF recognizes excess, obsolete, and unserviceable inventory and OM&S at a net realizable value of $0 pending development of an effective means of valuing such material.

Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by NWCF. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make it suitable for sale. Often, it is more economical to repair these items rather than to procure them. The NWCF often relies on weapon systems and machinery no longer in production and held for repair. As a result, NWCF supports a process that encourages the repair and rebuilding of weapon systems and machinery. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Work in process balances include (1) costs related to the production or servicing of items, including direct material, labor, applied overhead; (2) the value of finished products or completed services that are yet to be placed in service; and (3) munitions in production and depot maintenance work with its associated costs incurred in the delivery of maintenance services.

1.M. General Property, Plant and Equipment

Property, Plant and Equipment (PP&E) consists of two categories: General PP&E, and Stewardship PP&E. Military Equipment (a classification of General PP&E), Heritage Assets and Stewardship Land (classifications of Stewardship PP&E) are reported on the financial statements of the DON. The NWCF classifies all PP&E assets in the General PP&E category.

The DoD's General PP&E capitalization threshold is $100 thousand except for real property, which is $20 thousand. The NWCF has not fully implemented the threshold for real property: therefore, NWCF is primarily using the capitalization threshold of $100 thousand for General PP&E, and most real property.

General PP&E assets are capitalized in accordance with SFFAS No. 6, as amended by SFFAS Nos. 10, 23, and 35 when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD's capitalization

threshold. SFFAS 35 amends SFFAS 6 permitting the use of estimated PP&E values when historical cost information is not available. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold for General PP&E and extend the useful life or increase the size, efficiency, or capacity of the asset. The NWCF depreciates all General PP&E, other than land, on a straight-line basis.

When it is in the best interest of the government, the NWCF provides government property to contractors to complete contract work. The NWCF either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E meets or exceeds the DoD capitalization threshold, Federal accounting standards require that it be reported on NWCF's Balance Sheet.

The DoD developed policy and a reporting process for contractors with government furnished equipment that provides appropriate General PP&E information for financial statement reporting in accordance with Federal Acquisition Regulations (FAR). The DoD requires NWCF to maintain, in their property systems, information on all property furnished to contractors. These actions are structured to capture and report the information necessary for compliance with Federal accounting standards. The NWCF has not fully implemented this policy primarily due to system limitations.

NWCF capitalizes all PP&E used in the performance of its mission. These assets are capitalized as General PP&E whether they meet the definition of any other PP&E category.

1.N. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy as prescribed in SFFAS No. 1, Accounting for Selected Assets and Liabilities, is to record advances or prepayments in accordance with USGAAP. As such, payments made prior to the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The NWCF has not implemented this policy primarily due to system limitations.

1.O. Leases

In accordance with SFFAS No. 5, Accounting for Liabilities of the Federal Government, lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, NWCF records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The NWCF records the asset and the liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The NWCF, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are expensed over the lease term as they become payable.

Office space leases entered into by NWCF are the largest component of operating leases and are based on costs gathered from existing leases, General Services Administration (GSA) bills, and interservice support agreements. Future year projections use the Consumer Price Index.

1.P. Other Assets

Other assets include non-Federal advances and prepayments, military and civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on NWCF's Balance Sheet. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion. The Defense Federal Acquisition Regulation Supplement authorizes progress payments based on a percentage or stage of completion only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments based on percentage or stage of completion are reported as Construction in Progress. The NWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, NWCF may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms

and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost reimbursement contracts. It is DoD policy to record certain contract financing payments as other assets. The NWCF has not fully implemented this policy primarily due to system limitations.

Due to inconsistencies in the posting logic for non-Federal Advances and Prepayments, NWCF is noncompliant with the Federal Financial Management Improvement Act of 1996 (FFMIA),which requires agencies to comply with the Federal financial management systems requirements, standards promulgated by the Federal Accounting Standards Advisory Board (FASAB), and the USSGL at the transaction level.

1.Q. Contingencies and Other Liabilities

The DON is party to various administrative proceedings, legal actions, and claims. Under SFFAS No. 5, Accounting for Liabilities of the Federal Government, as amended by SFFAS No. 12, Recognition of Contingent Liabilities Arising from Litigation, the Balance Sheet should include estimated liabilities for these items, when an adverse decision is probable, reasonably possible, and estimable. When the amount of the potential loss cannot be estimated, or the likelihood of an unfavorable outcome is remote, the contingency is not disclosed.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The NWCF's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship, and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities also arise as a result of anticipated disposal costs for the DON NWCF assets. Consistent with SFFAS No. 6, "Accounting for Property, Plant and Equipment", recognition of an anticipated environmental liability begins when the asset is placed into service. The DON NWCF adheres to the DoD's policy, which is consistent with SFFAS No. 5 Accounting for Liabilities of Federal Government, and states that non-environmental disposal liabilities are recognized when management decides to dispose of an asset. The NWCF Environmental Liabilities are reported under the DON.

1.R. Accrued Leave

Military leave, compensatory and annual leave earned by civilians, but not yet used, is reported as accrued liabilities. The accrued balance is adjusted annually to reflect current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.S. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.T. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported disbursements and collections may be evidenced by the availability of corroborating documentation that would generally support the summary level adjustments made to accounts payable and receivable. Both supported and unsupported adjustments may have been made to the NWCF Accounts Payable and Receivable trial balances prior to validating underlying transactions required to establish the Accounts Payable/Receivable. As a result, misstatements of reported Accounts Payable and Receivables are likely present in the NWCF financial statements.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD is generally unable to determine whether undistributed disbursements and collections should be applied to Federal or non-Federal accounts payables/receivables at the time accounting reports are prepared. Accordingly, the DoD policy is to allocate supported undistributed disbursements and collections between Federal and non-Federal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Both supported and unsupported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly.

1.U. Federal Employee and Veteran Benefits

For financial reporting purposes, the DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON at the end of each fiscal year. Military retirement is accounted for in the audited financial statements of the Military Retirement fund; as such, NWCF does not record any liabilities or obligations for pensions or healthcare retirement benefits.

NOTE 2. NONENTITY ASSETS

As of September 30

(Amounts in thousands)

	2013	2012
Accounts Receivable with the Public	$ 10,285	$ 8,888
Total Entity Assets	28,788,679	26,800,934
Total Assets	$ 28,798,964	$ 26,809,822

Nonentity assets are assets for which the NWCF maintains stewardship accountability and reporting responsibility, but are not available for the NWCF's normal operations.

Nonentity Nonfederal Accounts Receivable (Public)
The nonentity non-Federal accounts receivable amount represents interest, penalties, fines and administrative fees that will be remitted to the U.S. Treasury.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30

(Amounts in thousands)

	2013	2012
Fund Balances		
Revolving Funds	$ 1,481,951	$ 1,334,582

Status of Fund Balance with Treasury

As of September 30

(Amounts in thousands)

	2013	2012
Unobligated Balance		
Available	$ 3,580,527	$ 3,694,934
Unavailable	54,761	39,563
Obligated Balance not yet Disbursed	12,937,256	12,494,009
Non-FBWT Budgetary Accounts	(15,090,593)	(14,893,924)
Total	$ 1,481,951	$ 1,334,582

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current and future obligations.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable amount primarily relates to Research and Development funding.

Obligated Balance not yet disbursed represents funds that have been obligated for goods and services not received, and those received but not paid.

Non-FBWT Budgetary Accounts reduces the Status of FBWT. This amount is comprised of contract authority, accounts receivable, and unfilled orders without advance from customers for the NWCF. Due to the DON systems inability to segregate Budgetary FBWT balances, Non-FBWT Budgetary Accounts are used to reconcile the Status of FBWT.

Other

As of September 30

(Amounts in thousands

	2013	2012
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	$ 1,481,951	$ 1,334,583
Fund Balance per the DON	1,481,951	1,334,582
Reconciling Amount	$ -	$ 1

NOTE 4. ACCOUNTS RECEIVABLE

As of September 30

(Amounts in thousands

2013	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 1,317,180	$ N/A	$ 1,317,180
Nonfederal Receivables (From the Public)	68,466	(3,637)	64,829
Total	$ 1,385,646	$ (3,637)	$ 1,382,009

As of September 30

(Amounts in thousands)

2012	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 1,083,381	$ N/A	$ 1,083,381
Nonfederal Receivables (From the Public)	54,760	(11,434)	43,326
Total	$ 1,138,141	$ (11,434)	$ 1,126,707

The accounts receivable represent the NWCF's claim for payment from other entities. Intragovernmental Receivables primarily represents amounts due from other Federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Claims with other Federal agencies are resolved in accordance with the Intragovernmental Business Rules. Non-Federal Accounts Receivable is mainly held with Naval Facilities Engineering Command and Naval Supply Systems Command. Since the DON is at risk of not collecting on these public accounts receivable, the DON is recognizing an allowance for uncollectible amounts. The methodology used in determining the allowance amount is discussed in Note 1.K.

The DON is currently working on an effort to drive compliance with OMB Circular A-11, Section 20.4(b)(4). Non-compliance results in unsupported departmental level adjustments which negatively impacts achievement of the DON's audit readiness goals for its Statement of Budgetary Resources. The DON is partnering with DFAS to clarify guidance, resolve funding issues and standardize business practices. In addition, the DON and the DFAS are aggressively pursuing collection mechanisms for amounts currently due from the public.

NOTE 5. OTHER ASSETS

As of September 30 (Amounts in thousands)	2013	2012
Intragovernmental Other Assets		
Advances and Prepayments	$ 46	$ 10
Outstanding Contract Financing Payments	627,322	521,037
Advances and Prepayments	1,433,278	1,105,100
Other Assets (With the Public)	927	2,311
Total Nonfederal Other Assets	2,061,527	1,628,448
Total	$ 2,061,573	$ 1,628,458

Non-Federal Other Assets - Outstanding Contract Financing Payments consist of contract terms and conditions for certain types of contract financing payments conveying specific rights to the NWCF that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and NWCF is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product. As a result, cash outlays and payments are made by the NWCF to contractors, grantees, or others to cover the recipients' anticipated and periodic expenses before those expenses are incurred. Outstanding Contract Financing Payments are reduced when goods and services are received, contract terms are met, progress is made on a contract, or prepaid expenses expire.

The balance of Outstanding Contract Financing Payments includes $584.2 million in contract financing payments and an additional $43.1 million in estimated future funded payments to contractors upon delivery and Government acceptance of a satisfactory product. See additional discussion in Note 13, Other Liabilities.

Due to reclassification of intragovernmental activity and inaccurate posting logic, non-Federal Advances and Prepayments are recognized within the NWCF.

Non-Federal Other Assets - Advances and Prepayments increased primarily due to Navy Supply Management reclassification of Federal Advances and Prepayments to non-Federal Advances and Prepayments in order to reconcile seller side trading partner data. The Navy ERP proprietary posting logic is not correctly relieving advances which caused the Federal advances account to be overstated due to the posting logic's noncompliance with USSGL. The issue has been logged in the Navy ERP PMO Quality Center and NWCF will continue to work on a resolution.

Non-Federal Other Assets consists of prepayments made to vendors and travel advances made to employees.

NOTE 6. CASH AND OTHER MONETARY ASSETS

As of September 30 (Amounts in thousands)	2013	2012
Cash	$ 11,664	$ 295

NWCF Cash consists of coins, paper currency and readily negotiable instruments; such as money orders, checks, and bank drafts on hand or in transit for deposit.

NOTE 7. INVENTORY AND RELATED PROPERTY

As of September 30

(Amounts in thousands)

		2013		2012
Inventory, Net	$	21,504,495	$	20,308,607
Operating Materials & Supplies, Net		200,921		176,693
Total	$	21,705,416	$	20,485,300

Inventory, Net

As of September 30

(Amounts in thousands)

2013	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
Inventory Categories				
Available and Purchased for Resale	$ 8,945,861	$ (987,112)	$ 7,958,749	MAC, LAC
Held for Repair	13,709,579	(194,511)	13,515,068	LAC, MAC
Excess, Obsolete, and Unserviceable	667,405	(667,405)	-	NRV
Work in Process	30,679	-	30,679	AC
Total	$ 23,353,524	$ (1,849,028)	$ 21,504,496	

As of September 30

(Amounts in thousands)

2012	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
Inventory Categories				
Available and Purchased for Resale	$ 8,285,011	$ (934,683)	$ 7,350,328	LAC, MAC
Held for Repair	13,086,366	(159,157)	12,927,209	LAC, MAC
Excess, Obsolete, and Unserviceable	537,735	(537,735)	-	NRV
Work in Process	31,070	-	31,070	AC
Total	$ 21,940,182	$ (1,631,575)	$ 20,308,607	

Legend for Valuation Methods:

LAC = Latest Acquisition Cost
NRV = Net Realizable Value
MAC = Moving Average Cost
AC = Actual Cost
LCM = Lower of Cost or Market

General Composition of Inventory

Inventory available and purchased for resale includes consumable spare and repair parts as well as reparable items owned and managed by the NWCF. Inventory includes all material available for customer purchase. Inventory is assigned to categories based upon condition of the inventory items, or in the case of raw material and work-in-process based upon stage of fabrication. Inventory held for repair consists of damaged material that requires repair to make it usable. Excess inventory includes scrap materials or items that are uneconomical to repair and are awaiting disposal. Work in process includes costs related to the production or servicing of items, including direct material, direct labor, applied overhead, and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer.

Federal Accounting Standards require disclosure of the amount of Inventory Held for "Future Use". Beginning with Fiscal Year (FY) 2012 the NWCF will report this balance separate from Inventory Available and Purchased for Resale. The NWCF currently has $609.9 million and $0.5 million reported from 4th Quarter, FY 2013 and 2012, respectively in Inventory Held for Future Use, Net.

Inventory Valuation

Navy's inventory is reported using two methods: the approximation of historical cost method and Moving Average Cost (MAC). The approximation of historical cost is calculated by using the Latest Acquisition Cost (LAC) less the allowance for holding gains and losses. MAC is calculated each time costs are incurred for a purchase or a repairable

item is remanufactured by dividing the cost of total units available at the time. Legacy inventory systems are designed to capture materiel management information rather than accounting data. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, Accounting for Inventory and Related Property. The OUSD (C) Cost of Goods Sold Model revalued inventory causing NWCF to be non-compliant with SFFAS No. 3. The Navy Enterprise Resource Planning System (ERP) values inventory at MAC in accordance with U.S. Generally Accepted Accounting Principles (USGAAP). As of 4th Quarter, FY13, 99% of NWCF inventory was valued at MAC. For compliance, the revaluation of the inventory to MAC occurred in the field accounting system to be compliant with SFFAS No. 3.

Restrictions on Use of Inventory

There are no restrictions on the use, sale, or disposition of inventory except in the following situations:

1) Distributions without reimbursement are made when authorized by Department of Defense (DoD) directives;
2) War reserve materiel in the amount of $54.2 million includes repair items that are considered restricted; and
3) Inventory, with the exception of safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

There are no known restrictions on disposition of inventory as related to environmental or other liabilities.

Operating Materials and Supplies, Net

As of September 30

(Amounts in thousands)

	2013			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use	$ 200,912	$ -	$ 200,912	LAC, MAC
Held for Repair	8	-	-	LAC, MAC
Total	$ 200,920	$ -	$ 200,912	

As of September 30

(Amounts in thousands)

	2012			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use	$ 176,693	$ -	$ 176,693	LAC, MAC
Held for Repair	-	-	-	LAC, MAC
Total	$ 176,693	$ -	$ 176,693	

Legend for Valuation Methods:

LAC = Latest Acquisition Cost MAC = Moving Average Cost

Federal Accounting Standards require disclosure of the amount of OM&S Held for "Future Use." Beginning with Fiscal Year (FY) 2012 the NWCF will report this balance separate from OM&S Held for Use. The NWCF reports that $0.2 and $0.4 million of OM&S is Held for Future Use and is included in the "held for use" category as of September 30, 2013 and 2012, respectively. These items are not readily available in the market and there is a more than a remote chance that they will eventually be needed.

NOTE 8. GENERAL PP&E, NET

As of September 30

(Amounts in thousands)

2013	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 31,272	$ N/A	$ 31,272
Buildings, Structures, and Facilities	S/L	20 or 40	6,735,400	(5,393,651)	1,341,749
Software	S/L	2-5 or 10	368,643	(299,647)	68,996
General Equipment	S/L	5 or 10	2,635,761	(2,146,907)	488,854
Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	225,480	N/A	225,480
Other	N/A	N/A	-	-	-
Total General PP&E			$ 9,996,556	$ (7,840,205)	$ 2,156,351

As of September 30

(Amounts in thousands)

2012	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 31,272	$ N/A	$ 31,272
Buildings, Structures, and Facilities	S/L	20 or 40	6,684,421	(5,244,382)	1,440,039
Software	S/L	2-5 or 10	364,656	(287,331)	77,325
General Equipment	S/L	5 or 10	2,603,496	(2,118,744)	484,752
Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	201,078	N/A	201,078
Other	N/A	N/A	14	-	14
Total General PP&E			$ 9,884,937	$ (7,650,457)	$ 2,234,480

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable

General Composition of General Property, Plant and Equipment

NWCF General Property, Plant and Equipment (PP&E) consists of buildings and structures, lease hold improvements, software, general equipment and Construction-in-Progress. General PP&E, Other consists of assets awaiting disposal.

General Property, Plant and Equipment Valuation

The acquisition cost for General PP&E is captured and maintained in the applicable accountable property systems of record. The methodology used in capitalizing General PP&E assets is discussed in Note 1.N.

Restrictions on Use of Property, Plant and Equipment

There are no known restrictions on the use or convertibility of PP&E.

NOTE 9. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30

(Amounts in thousands)

	2013	2012
Intragovernmental Liabilities		
Other	$ 161,761	$ 168,029
Federal Employee and Veteran Benefits	774,032	757,427
Total Liabilities Not Covered by Budgetary Resources	$ 935,793	$ 925,456
Total Liabilities Covered by Budgetary Resources	$ 5,482,267	$ 4,845,833
Total Liabilities	$ 6,418,060	$ 5,771,289

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through Congressional appropriations or earnings of the entity.

Intragovernmental Liabilities – Other consists of the unfunded portion of Federal Employees' Compensation Act (FECA) liability due to the Department of Labor and unemployment compensation due to applicable States. These liabilities will be funded by future year's budgetary resources.

Federal Employee and Veteran Benefits consist of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities represent FECA Actuarial liabilities that will be funded in future periods. Refer to Note 14, Federal Employee and Veteran Benefits, for additional details and disclosures.

NOTE 10. ACCOUNTS PAYABLE

As of September 30

(Amounts in thousands)

2013	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 192,102	$ N/A	$ 192,102
Nonfederal Payables (to the Public)	3,741,192	-	3,741,192
Total	$ 3,933,294	$ -	$ 3,933,294

As of September 30

(Amounts in thousands)

2012	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 184,615	$ N/A	$ 184,615
Nonfederal Payables (to the Public)	3,015,987	-	3,015,987
Total	$ 3,200,602	$ -	$ 3,200,602

Accounts Payable includes amounts owed to Federal and non-Federal entities for goods and services received by NWCF. The NWCF's systems do not track intra-governmental transactions by customer at the transaction level. As a result, in the intra-governmental eliminations process, buyer-side accounts payable are adjusted to agree with supportable intra-agency seller-side accounts receivable. This is accomplished by (1) reclassifying amounts between Federal and non-Federal cost categories, (2) accruing additional accounts payable and expenses, and (3) applying both supported and unsupported undistributed disbursements at the reporting entity level.

NOTE 11. ENVIRONMENTAL LIABILITIES AND DISPOSAL LIABILITIES

The NWCF Environmental Liabilities are reported under the DON financial statements.

NOTE 12. OTHER LIABILITIES

As of September 30

(Amounts in thousands)

	2013		
	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	$ 142,441	$ -	$ 142,441
FECA Reimbursement to the Dept. of Labor	74,364	87,398	161,762
Custodial Liabilities	10,285	-	10,285
Employer Contribution and Payroll Taxes Payable	27,555	-	27,555
Total Intragovernmental	254,645	87,398	342,043
Accrued Funded Payroll and Benefits	1,043,768	-	1,043,768
Advances from Others	276,892	-	276,892
Deposit Funds and Suspense Accounts	99	-	99
Contract Holdbacks	1,647	-	1,647
Employer Contribution and Payroll Taxes Payable	3,212	-	3,212
Contingent Liabilities		43,088	43,088
Other Liabilities	(15)	-	(15)
Total Other Liabilities	$ 1,580,248	$ 130,486	$ 1,710,734

As of September 30

(Amounts in thousands)

	2012		
	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	$ 331,098	$ -	$ 331,098
FECA Reimbursement to the Dept. of Labor	73,769	94,261	168,030
Employer Contribution and Payroll Taxes Payable	23,413	-	23,413
Total Intragovernmental	437,168	94,261	531,429
Accrued Funded Payroll and Benefits	1,039,118	-	1,039,118
Advances from Others	206,870	-	206,870
Deposit Funds and Suspense Accounts	60	-	60
Contract Holdbacks	838	-	838
Employer Contribution and Payroll Taxes Payable	5,005	-	5,005
Contingent Liabilities	-	26,214	26,214
Other Liabilities	3,726	-	3,726
Total Other Liabilities	$ 1,692,785	$ 120,475	$ 1,813,260

Contingent Liabilities includes $43.1 million related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractor's work vest with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. It is DoD policy that these rights should not be misconstrued as the rights of ownership. The NWCF is under no obligation to pay the contractor for amounts greater than the amounts of progress payments authorized in the contract until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid are estimable, the NWCF has recognized a contingent liability for the estimated unpaid costs that are considered conditional for payment pending delivery and government acceptance.

Total contingent liabilities for progress payments based on cost represent the difference between the estimated costs incurred to date by contractors and amounts authorized to be paid under progress payments based on cost provisions within the FAR. Estimated contractor-incurred costs are calculated by dividing the cumulative unliquidated progress payments based on cost by the contract-authorized progress payment rate. The balance of unliquidated progress payments based on cost is deducted from the estimated total contractor-incurred costs to determine the contingency amount.

The abnormal balance in non-Federal Other Liabilities is under investigation. It is likely related to ongoing general ledger posting issues to be addressed through audit readiness efforts.

NOTE 13. COMMITMENTS AND CONTINGENCIES

The NWCF is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The NWCF has accrued contingent liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The NWCF records contingent liabilities in Note 12, Other Liabilities.

For FY 2013, NWCF materiality threshold for reporting litigation, claims, or assessments is $3.7 million. The NWCF OGC conducts a review of litigation and claims threatened or asserted involving NWCF to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The NWCF currently has 4 cases that meet the existing FY 2013 materiality threshold. NWCF legal counsel was unable to express an opinion concerning the likely outcome on 2 of 4 cases.

The DON is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures.

NOTE 14. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30

(Amounts in thousands)

2013	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits				
FECA	$ 774,032		$ -	$ 774,032

As of September 30

(Amounts in thousands)

2012	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits				
FECA	$ 757,427		$ -	$ 757,427

The NWCF reports an actuarial liability for the Federal Employee's Compensation Act (FECA). FECA provides Federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. FECA is administered by the Office of Workers' Compensation Programs.

The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

Actuarial Cost Method Used

The NWCF's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to NWCF only at the end of each fiscal year.

The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period.

NOTE 15. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

As of September 30

(Amounts in thousands)

Intragovernmental Costs and Exchange Revenue

	2013	2012
Intragovernmental Costs	$ 5,348,164	$ 4,932,504
Nonfederal Cost	23,609,017	30,538,293
Total Costs	$ 28,957,181	$ 35,470,797
Intragovernmental Earned Revenue	$ (24,818,135)	$ (25,935,532)
Nonfederal Revenue	(1,772,033)	(7,490,206)
Total Revenue	$ (26,590,168)	$ (33,425,738)
Total Net Cost	$ 2,367,013	$ 2,045,059

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government that are supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department of Defense's (DoD) current processes and systems do not capture and report accumulated cost for major programs based upon the performance measures as required by the Government Performance and Results Act. The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4. "Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 30, "Inter-entity Cost Implementation."

Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a non-Federal entity. Large balances in the Public costs and revenue lines are a result of the current process in Navy Enterprise Resource Planning. The process produces inflated gains and offsetting losses on separate financial statement and note schedule lines, however, the impact on Net Cost is reduced when the gains and losses are combined. The Navy is currently working to resolve the business process that results in daily postings to the gain and loss accounts for in-transit inventory.

The NWCF's financial management systems do not track intragovernmental transactions by customer at the transactional level. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between Federal and non-Federal expenses. Intradepartment revenues and expenses are then eliminated.

NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

The Statement of Changes in Net Position (SCNP) reports the change in net position during the reporting period. Net position is affected by changes to its two components: Cumulative Results of Operations and Unexpended Appropriations.

NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30

(Amounts in thousands)

	2013	2012
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 9,498,826	$ 9,351,801

Apportionment Categories of Obligations Incurred

Obligations Incurred – Direct	Category A	$0
Obligations Incurred – Direct	Category B	$24 million
Obligations Incurred – Reimbursable	Category B	$28.8 billion
Obligations Incurred – Reimbursable	Exempt from Apportionment	$0

Other Disclosures

The Statement of Budgetary Resources includes intra-entity transactions because the statements are presented as combined.

NOTE 18. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30

(Amounts in thousands)

	2013	2012
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations incurred	$ 28,855,188	$ 30,439,413
Less: Spending authority from offsetting collections and recoveries (-)	(29,674,994)	(31,978,984)
Net obligations	(819,806)	(1,539,571)
Other Resources:		
Transfers in/out without reimbursement (+/-)	461,027	341,583
Imputed financing from costs absorbed by others	515,872	538,390
Other (+/-)	2,708,285	1,664,623
Net other resources used to finance activities	3,685,184	2,544,596
Total Resources Used to Finance Activities	$ 2,865,378	$ 1,005,025
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders (-)	$ (147,026)	$ (420,335)
Unfilled Customer Orders	893,775	1,587,250
Resources that fund expenses recognized in prior periods (-)	(8,878)	(2,565)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	-	-
Resources that finance the acquisition of assets (-)	(5,376,250)	(7,729,627)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
Other (+/-)	(3,169,313)	(2,006,205)
Total resources used to finance items not part of the Net Cost of Operations	$ (7,807,692)	$ (8,571,482)
Total resources used to finance the Net Cost of Operations	$ (4,942,314)	$ (7,566,457)

As of September 30 (Amounts in thousands)		2013		2012
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
Other (+/-)		19,215		27,161
Total components of Net Cost of Operations that will Require or Generate Resources in future periods		19,215		27,161
Components not Requiring or Generating Resources:				
Depreciation and amortization	$	288,436	$	303,927
Revaluation of assets or liabilities (+/-)		1,885,071		1,977,398
Other (+/-)				
Cost of Goods Sold		8,486,903		11,011,284
Operating Material and Supplies Used		-		-
Other		(3,370,297)		(3,708,254)
Total Components of Net Cost of Operations that will not Require or Generate Resources		7,290,113		9,584,355
Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	7,309,328	$	9,611,516
Net Cost of Operations	$	2,367,014	$	2,045,059

The Reconciliation of Net Cost of Operations to Budget provides information about the total resources used by the NWCF. It is designed to explain how those resources were used to finance orders for goods and services not yet delivered, acquire assets and liabilities, and fund the NWCF's net cost of operations. It is intended to report the differences and facilitate the reconciliation of accrual based amounts used in the Statement of Net Cost (SNC) and obligation-based amounts used in the Statement of Budgetary Resources (SBR). The computations and presentation of items in the Reconciliation of Net Cost of Operations to Budget demonstrate that the budgetary and proprietary information in an entity's financial management system agrees.

Due to NWCF financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. The difference between budgetary and proprietary data is a previously identified deficiency.

The following Reconciliation of Net Cost of Operations to Budget lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

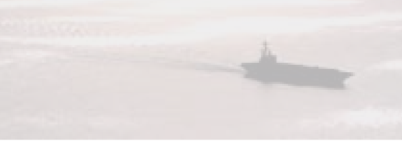
- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

NOTE 19. DISCLOSURES RELATED TO INCIDENTAL CUSTODIAL COLLECTIONS

NWCF collected $14.3 million of incidental custodial revenues generated primarily from surcharges, interest, penalties, fines and administrative fees. These funds are not available for use by NWCF. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.

Department of the Navy Fiscal Year 2013 Annual Financial Report

Navy Working Capital Fund
Required Supplementary Information



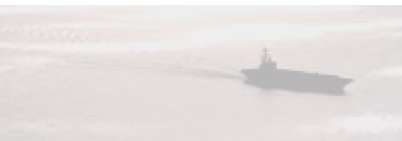

Navy Working Capital Fund
General Property, Plant, and Equipment
Real Property Deferred Maintenance and Repair

For Fiscal Year Ended September 30, 2013

The Navy Working Capital Fund real property deferred maintenance and repair information for fiscal year ended September 30, 2013 is reported with the Department of the Navy deferred maintenance and repair. See Department of the Navy Required Supplementary Information.

Department of the Navy Fiscal Year 2013 Annual Financial Report

Navy Working Capital Fund
Other Accompanying Information




Reporting Entity
Navy Working Capital Fund (NWCF)

Fund / Account Treasury Symbol and Title

97X4930.002

Navy Working Capital Fund Activity Group Treasury Symbol and Title

97X4930.NA1*	Depot Maintenance – Shipyards[a]
97X4930.NA2*	Depot Maintenance – Aviation
97X4930.NA4A*	Depot Maintenance – Other, Marine Corps
97X4930.NA3*	Ordnance[b]
97X4930.ND*	Transportation
97X4930.NE*	Base Support
97X4930.NH*	Research and Development
97X4930.NC*	Supply Management
97X4930.NC2A*	Supply Management, Marine Corps

NOTES:
* The "*" represents alpha or numeric characters which identify an activity or reporting segment of the activity group.

a Depot Maintenance, Shipyards became a part of the DON in FY 2007. The Depot Maintenance, Shipyards information included in this report represents residual NWCF accounting.

b The Ordnance activity group became a part of the DON in FY 2000. The Ordnance information included in this report represents residual NWCF accounting for this group.

Cover Credits

A Marines and Sailors through the choppy waters in a combat rubber raiding craft, en route to their objective during boat raid exercise. (Photo By: Lance Cpl. Caleb Hoover)

B First-year midshipmen, or plebes, participate in the U.S. Naval Academy's annual Sea Trials. (U.S. Navy photo by Mass Communication Specialist 1st Class Chad Runge/Released)

C Hospital Corpsmen transfer medical supplies aboard an amphibious dock landing ship during Pacific Partnership 2013. (U.S. Navy photo by Mass Communication Specialist 3rd Class Carlos M. Vazquez II/Released)

D Sailors take in mooring lines as an amphibious transport dock ship Pre-Commissioning Unit (PCU) Anchorage (LPD 23) gets underway. (U.S. Navy photo by Mass Communication Specialist 1st Class James R. Evans/Released)

E A Marine Corps Cpl. embarked on an amphibious dock landing ship, gets out of a Navy Landing Craft Utility. (U.S. Navy photo by Mass Communication Specialist 3rd Class Christopher Lindahl/Released)

F An aircraft carrier conducts training operations in the Atlantic Ocean. (U.S. Navy photo by Mass Communication Specialist 2nd Class Michael Smevog/Released)

G An Electronics Technician and Ensigns act as the reconnaissance team aboard a littoral combat ship during a simulated small boat threat Exercise. (U.S. Navy photo by Mass Communication Specialist 1st Class Cassandra Thompson/Released)

H An X-47B Unmanned Combat Air System (UCAS) demonstrator flies over the flight deck of an aircraft carrier. (U.S. Navy photo by Mass Communication Specialist 3rd Class Brian Read Castillo/Released)

I An F/A-18C Hornet makes an arrested landing on the flight deck of an aircraft carrier. (U.S. Navy photo by Mass Communication Specialist Seaman Scott Fenaroli/Released)

Preparation of this report cost the Department of the Navy approximately $102,000 in Fiscal Year 2013.
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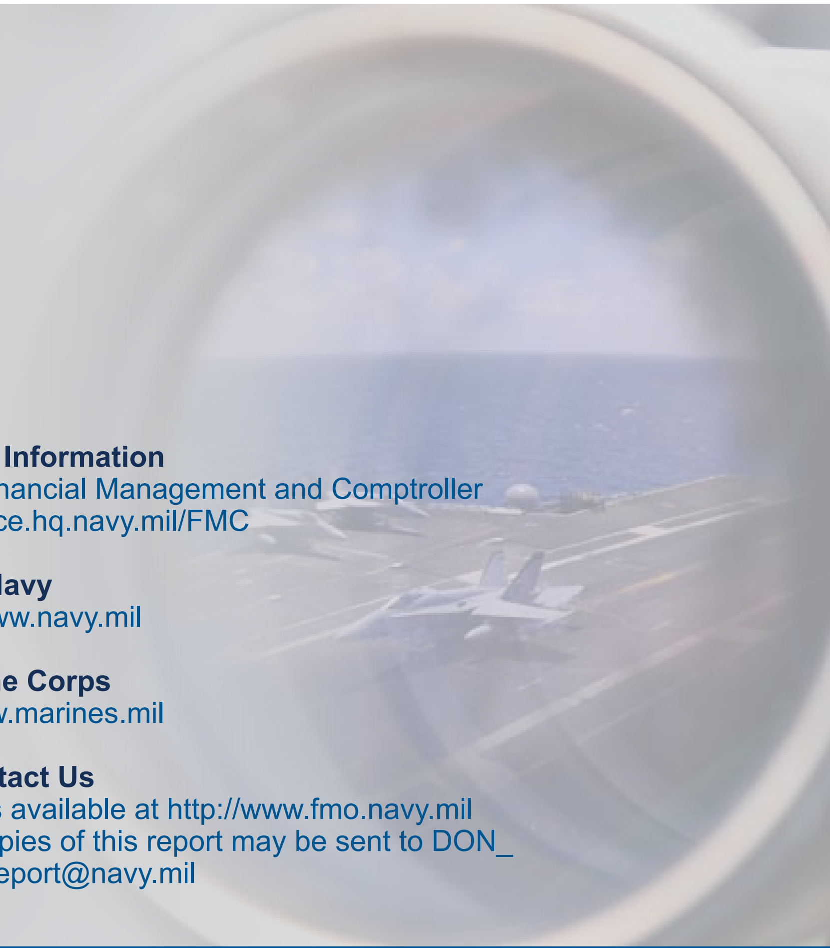
2013



For More Information
Assistant Secretary of the Navy Financial Management and Comptroller
http://www.finance.hq.navy.mil/FMC

Navy
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Marine Corps
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